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SOAH DOCKET NO. 473-21-0538
PUC DOCKET NO. 51415

APPLICATION OF SOUTHWESTERN ELECTRIC POWER COMPANY FOR AUTHORITY TO CHANGE RATES	§	BEFORE THE STATE OFFICE
	§	OF
	§	ADMINISTRATIVE HEARINGS

CITIES ADVOCATING REASONABLE DEREGULATION'S

INITIAL POST-HEARING BRIEF

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CITIES ADVOCATING REASONABLE DEREGULATION'S INITIAL POST-HEARING BRIEF

The Cities Advocating Reasonable Deregulation[1] ("CARD") hereby submit their Initial Post-Hearing Brief and in support thereof, show as follows:

I. Introduction/Summary [Preliminary Order (PO) Issues 1, 2, and 3]

CARD extends its thanks and gratitude to the Administrative Law Judges ("ALJs") for their attention to this case, their fairness in the conduct of the hearing, and most importantly, their patience with the parties, particularly given the challenges of presiding over a hearing on the merits via the medium of Zoom.

CARD respectfully urges the ALJs to adopt the adjustments to Southwestern Electric Power Company's ("SWEPCO" or the "Company") proposed revenue requirement set forth in summary fashion in CARD Exhibit No. 6, the direct testimony of Mr. Karl Nalepa, including the cost of capital proposed by Dr. J. Randall Woolridge's direct testimony presented in CARD Exhibit No. 4.

Based on the adjustments summarized in Mr. Nalepa's testimony, for SWEPCO's retail operations in Texas, CARD urges the ALJs to find a revenue deficiency of $34,800,903,[2] which represents a reduction of $70,255,335 to SWEPCO's claimed revenue deficiency of $105,026,238

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[1] The Cities Advocating Reasonable Deregulation is comprised of the Cities of Atlanta, Bloomberg, Carthage, Center, Daingerfield, Fruitvale, Gilmer, Gladewater, Hawkins, Henderson, Hooks, Jefferson, Kilgore, Lakeport, Longview, Marshall, Maud, Mineola, Mt. Enterprise, Mt. Pleasant, Mt. Vernon, Naples, New London, Omaha, Overton, Pittsburg, Queen City, Red Lick, Texarkana, Wake Village, Waskom, Wellington, White Oak, Winnsboro and Winona.

[2] *See* CARD Exh. 6 – Direct Testimony and Attachments of Karl Nalepa at 4 – Figure 1 ("CARD Exh. 6 – Nalepa Dir. at __.").

before revenue offsets related to revenue SWEPCO currently recovers through its Transmission Cost Recovery Factor ("TCRF") and its Distribution Cost Recovery Factor ("DCRF").[3]

Subtracting the TCRF and DCRF revenues from CARD's revenue deficiency for SWEPCO's Texas retail jurisdiction results in a net revenue deficiency of $19,974,401, an increase of 5.8% over SWEPCO's adjusted base-rate revenues for its Test Year ending March 31, 2020.[4]

II. Invested Capital - Rate Base [PO Issues 4, 5, 10, 11, 12, 13, 14, 15, 16, 18, 19, 20, 21, 22]

A. Generation, Transmission, and Distribution Capital Investment [PO Issues 4, 5, 10, 11, 13, 14, 15, 16]

1. Dolet Hills Power Station [PO Issues 67, 68, 69, 70, 71]

SWEPCO announced that it will retire its Dolet Hills generating plant by December 31, 2021, which is 25 years before the end of its currently approved useful life.[5] SWEPCO's decision to retire Dolet Hills markedly sooner than its useful life raises numerous issues regarding the appropriate rate-making treatment to afford Dolet Hills. No party to this proceeding expressed opposition to SWEPCO's decision. However, CARD, as well as the Staff of the Public Utility Commission, Texas Industrial Energy Consumers, and the Office of Public Utility Counsel all oppose SWEPCO's unorthodox, unsupportable and unreasonable rate-making treatment to account for the Dolet Hills generating station retirement.

SWEPCO seeks to recover the remaining undepreciated balance of the value of Dolet Hills by offsetting that balance by the Company's accrued Excess Deferred Federal Income Tax (EDFIT) balances.[6] But because those balances are less than the remaining plant balance, SWEPCO proposes to recover in rates the remaining undepreciated balance of plant related to

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[3] SWEPCO's current rates recover $14,826,502 through its TCRF and its DCRF. CARD Exh. 6 – Nalepa Dir. at 5.

[4] *Id.*

[5] SWEPCO Exh. 4 – Direct Testimony of Thomas P. Brice at 6 (hereinafter, "SWEPCO Exh. 4 – Brice Dir. at __."); Staff Exh. 3 – Direct Testimony of Ruth Stark at 25 (hereinafter, "Staff Exh. 4 – Stark Dir. at __.").

[6] SWEPCO Exh. 4 – Brice Dir. at 7. The Company's EDFIT balances result from its collection of federal income tax expense amounts from ratepayers at the higher 35% tax rate that SWEPCO would no longer need to pay to the federal government due to the passage of the Tax Cut and Jobs Act ("TCJA") of 2017 which lowered the rate to 21%. CARD Exh. 2 – Direct Testimony and Exhibits of Mark E. Garrett at 4 (hereinafter, "CARD Exh. 2 – M. Garrett Dir. at __.").

Dolet Hills over four years instead of over the 25 years of remaining life the Commission recently approved.[7] CARD urges the ALJs and the Commission to reject SWEPCO's proposal for the following reasons.

SWEPCO's proposal to accelerate depreciation of the undepreciated balance of Dolet Hills conflicts with the Commission's decision in Docket No. 46449.[8] In Docket No. 46449, the Commission determined that it was appropriate to allow SWEPCO to recover the remaining undepreciated balance of its retired Welsh Unit 2 generating plant over its original useful life of 24 years.[9] SWEPCO's proposal in this case to accelerate its recovery of the undepreciated balance of Dolet Hills (net of the EDFIT offset) over four years, instead of the 25 years of remaining life is contrary to recent Commission precedent.

SWEPCO contends that the Generally Accepted Accounting Principles ("GAAP") and "standard regulatory practice" support its decision to depreciate Dolet Hills in 2021, the new date of retirement SWEPCO announced.[10] SWEPCO made the same argument in Docket No. 46449. SWEPCO was wrong in Docket No. 46449 and it is wrong in this proceeding, too. The Commission rejected that argument in Docket No. 46449, and so, CARD urges the Commission to again reject SWEPCO's argument in this case, too.

As CARD witness Mark Garrett explained, neither GAAP nor standard regulatory practice support SWEPCO's position.[11] When a plant is retired early, the remaining undepreciated plant balance as of the early retirement date is transferred into a regulatory asset account to be recovered over any period of time the regulators deem appropriate. Critically, once the asset is transferred to a regulatory asset account the depreciation rules no longer apply because those rules only apply to plant in service and not plant that has been taken out of service. This is precisely what the Commission ordered in Docket No. 46449 and CARD urges the Commission to do the same in this case.[12]

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7 SWEPCO Exh. 4 – Brice Dir. at 8.

8 *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 46449.

9 *Id* at Order on Rehearing at FOF 70 (Mar. 19, 2018) (hereinafter, "Docket No. 46449, Order on Rehearing at __.").

10 CARD Exh. 2 – M. Garrett Dir. at 11.

11 *Id* at 10-11.

12 Docket No. 46449, Order on Rehearing at FOF 70-71.

The Commission's decision in Docket No. 46449 to not accelerate the costs of Welsh Unit 2 recognizes that the undepreciated costs should not be born entirely by current ratepayers, but rather, the costs should be spread out among future ratepayers as well. From a policy perspective, the Company's proposal to accelerate recovery of Dolet Hills' remaining undepreciated plant balance not only creates intergenerational inequities, but also would unduly increase costs for ratepayers at a time least affordable.[13] Not only have many of SWEPCO's customers suffered financially during the COVID-19 pandemic, but the recent catastrophic weather events that occurred on and around February 14, 2021 have caused fuel costs to increase which will impose additional financial burdens on customers.[14] This is simply an inappropriate time to accelerate cost recovery at ratepayers' expense.

Moreover, by spreading costs out over a longer period of time into the future, opportunities may arise to offset some of the costs with other savings. Examples of these additional savings include:

- Improvements in technology that tend to lower costs going forward such as is the case with solar and wind power, the costs of which have decreased substantially in recent years. When the costs of early plant retirements are spread out over a reasonable amount of time into the future, the lower costs that result from improved technologies can help offset them.[15]
- Operating efficiencies that help lower costs over time; the Bureau of Labor Statistics has determined that these gains average about 1% per year and more than that in some sectors.[16]
- The potential that abnormally high investment levels to comply with environmental regulations in recent years will subside over time as capital costs are repaid through depreciation recoveries. Since one of these environmental compliance costs are the stranded costs that result from early plant retirements, the pay-down of these costs should occur over time as well.[17]
- The advent of lower capital costs that help offset the costs of early plant termination. The cost of equity and debt is much lower than it was in the recent past. These lower

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[13] CARD Exh. 2 – M. Garrett Dir. at 5-6.

[14] *Id.*

[15] *Id* at 6.

[16] *Id.*

[17] *Id.* at 6-7.

capital costs can be used to significantly offset the higher plant termination costs if the termination costs are spread out over time.[18]

- Growth in load. As load grows over time, the fixed costs of the utility, including asset recovery costs are spread over more kWh sales, reducing over time the unit cost per customer. This benefit increases with more prolonged recovery time.[19]

Further, requiring SWEPCO to depreciate Dolet Hills over its originally scheduled retirement date is consistent with the regulatory treatment afforded other generating plants owned by SWEPCO's parent company American Electric Power, Inc. ("AEP") and other utilities in other states. In 2015, AEP retired thirteen coal plants in four states, and all of those plants had undepreciated plant balances that were ordered to be recovered over amortization periods of 25- and 30-years, in line with their originally scheduled retirement dates.[20] In particular, the Oklahoma Commerce Commission ("OCC") rejected AEP-Public Service Company of Oklahoma's ("PSO") request to accelerate the recovery of the undepreciated plant balances of two coal units through 2026, and instead required that PSO continue to depreciate the units through 2040 to mitigate rate increases.[21] In New Mexico, the Public Service Company of New Mexico agreed to write off 50% of the undepreciated plant balance of two coal units at retirement and place the remaining balance in a regulatory-asset account when the plants are retired and recover that balance over 20 years.[22]

Once Dolet Hills is retired in December 2021, it will no longer be used and useful and cannot be included in rate base earning a return.[23] In Docket No. 46449, the Commission removed the remaining balance of Welsh Unit 2 from rate base because it was no longer used and useful in providing service to the public, but allowed SWEPCO to collect the remaining undepreciated value of the plan over its remaining useful life.[24] The status of Dolet Hills is somewhat different from Welsh Unit 2 in that it has not yet been retired, will arguably remain used and useful for a few more months, and to the extent it is used and useful in providing service to the public, may be included in rate base.

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[18] *Id.* at 7.

[19] *Id.*

[20] *Id* at 8.

[21] *Id.* at 9.

[22] *Id* at 10.

[23] *See* PURA § 36.051.

[24] Docket No. 46449, Order on Rehearing at FOFs 70-71.

To recognize the cost-savings that should accrue to ratepayers when the Dolet Hills is retired, CARD witness Mark Garrett recommends that the Commission order the establishment of a regulatory liability to accumulate the return on the remaining balance of Dolet Hills at the time of retirement.[25] Assuming Dolet Hills is actually retired in December 2021, the regulatory liability will accrue the return on Dolet Hills for the years 2022, 2023, 2024 and 2025 until new rates from the Company's next rate case, expected to be filed in about four years, are implemented.[26] The balance in the regulatory-liability account would then be returned to ratepayers over the four-year period rates from SWEPCO's next rate case are expected to be in effect.[27] Mr. Garrett's recommendation is balanced; it permits SWEPCO the opportunity to earn a return on Dolet Hills for the time it is used and useful in providing service to the public and provides ratepayers the cost-savings that should be recognized once Dolet Hills is taken out of service.

Regarding the correct rate-making treatment to be afforded Dolet Hills and the more appropriate use of the EDFIT balances, CARD urges the ALJs and the Commission to:

- Reject SWEPCO's proposal to use the EDFIT balances to offset the reaming net balances of the Dolet Hills Plant;
- Return the available EDFIT balances to rate-payers over a four-year period to coincide with SWEPCO's scheduled rate-case cycle;
- Reject SWEPCO's proposal to accelerate depreciation on Dolet Hills to recover the remaining undepreciated balance after the EDFIT offset;
- Maintain Dolet Hills' current depreciation rates;
- Establish a regulatory liability to accumulate the return collected from ratepayers each year on the remaining Dolet Hills balance after SWEPCO retires the plant and until SWEPCO's next rate case; and
- Recognize that the regulatory-liability account associated with the return dollars attributable to Dolet Hills after it is no longer used and useful, and to be refunded to ratepayers, can also be used to reduce rates to reflect that SWEPCO will also no longer incur O&M costs related to Dolet Hills after it retires the plant.[28]

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[25] CARD Exh. 2 – M. Garrett Dir. at 13.

[26] *Id* at 13-14.

[27] *Id* at 14.

[28] CARD also notes that certain Dolet Hills operating-and-maintenance expenses will be reduced or eliminated with the plant's retirement and thus recommends that those savings also be returned to ratepayers. *See* CARD Exh. 3 – Redacted Direct Testimony and Attachments of Scott Norwood at 5-6 (hereinafter, "CARD Exh. 3 – Norwood Dir. at __.").

2. Retired Gas-Fired Generating Units [PO Issue 13]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

3. Coal and Lignite Fuel Inventories

The purpose of maintaining solid fuel inventories is to assure a continuous supply of coal and lignite of the appropriate quality to all of AEP's solid-fuel generating stations, delivered at a reasonable cost over a period of years so as to promote the generation of the lowest cost per kWh of electricity.[29] While too little inventory may result in power being curtailed, excessive levels of inventory add unnecessary costs to customers' rates. CARD urges the ALJs to recommend that the coal and lignite inventories at SWEPCO's five coal- and lignite-powered power plants be reduced to reflect a 30-day target inventory and the Test Year, daily-burn levels for the Flint Creek, Pirkey, Turk and Welsh power plants.

CARD also urges the ALJs to recommend that SWEPCO's lignite inventory for Dolet Hills be disallowed because SWEPCO plans to retire the plant no later than December 31, 2021,[30] and therefore, Dolet Hills will not require fuel inventory passed the end of 2021. Moreover, including expenditures for SWEPCO's requested fuel inventory for Dolet Hills in rates until SWEPCO files its next base-rate case is inconsistent with PURA's requirement that the Commission establish "just and reasonable rates"[31] given that Dolet Hills will be retired just a few months after the Commission issues its final order approving the Company's new rates in this proceeding.

SWEPCO proposes to include approximately $79 million in rate base for coal and lignite fuel inventory.[32] SWEPCO's requested coal and lignite fuel inventory is based on unsubstantiated inventory targets that do not accurately reflect the reduction in energy produced from the Company's coal and lignite units over the last several years, and most certainly do not reflect the upcoming retirement of Dolet Hills at the end of 2021.[33] Consequently, SWEPCO's requested

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[29] SWEPCO Exh. 25 – Direct Testimony of Amy E. Jeffries at 13-15 (hereinafter, "SWEPCO Exh. 25 – Jeffries Dir. at __.").

[30] Hearing on the Merits Transcript Vol. 1 at page 176 ("HOM TR. Vol. __ at __:__.).

[31] PURA § 36.003.

[32] CARD Exh. 3 – Norwood Dir. at 7.

[33] *See* HOM TR. Vol. 1 at 176:19.

fuel inventory greatly overstates the level of inventory that is needed to ensure continuous operations of the units.

SWEPCO requested coal and lignite inventory totals of approximately 1.92 million tons.[34] But as CARD witness, Mr. Scott Norwood testified, the amount of coal and lignite SWEPCO requested is excessive for two main reasons. First, the Company's inventory targets are based on 30 days or more of continuous operations of the units at full load. However, as shown in Table 2, below, Mr. Norwood's unrefuted testimony established that from 2014 through 2019, SWEPCO reduced production from its coal and lignite power plants by 36.5%,[35] and SWEPCO's own forecasts project that reduction to continue over the next several years with the scheduled retirements of the Dolet Hills and Pirkey Power Plants.

Table 2

SWEPCO Coal and Lignite Unit Energy Production (MWh)[36]

Year	Coal	Lignite	Total
2014	13,003,710	5,564,011	18,567,721
2015	10,055,152	5,749,048	15,804,200
2016	8,333,489	5,763,315	14,096,804
2017	10,294,571	4,486,396	14,780,967
2018	9,815,696	4,436,723	14,252,419
2019	8,676,347	3,110,283	11,786,630
		Decrease:	**36.5%**

Second, SWEPCO's requested level of coal and lignite inventory fails to adjust for the fact that SWEPCO intends to retire its Dolet Hills Power Plant no later than December 31, 2021. By requesting lignite inventory as if Dolet Hills was going to be used and useful beyond December 31, 2021, SWEPCO is ignoring a known and measurable material change in Dolet Hills' operations. Consequently, SWEPCO's lignite inventory request inflates the Company's inventory

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[34] CARD Exh. 3 – Norwood Dir. at 8.

[35] *Id* at 9 (Table 2).

[36] *Id.*

requirement to a level that is not reasonable or necessary to maintain a reliable supply of fuel for the Company's coal and lignite plants.

Further, SWEPCO announced that it will retire Dolet Hills by the end of 2021, and it also announced that in 2023, it will retire its other lignite powered plant, the Pirkey Power Plant.[37] Subsequently, SWEPCO expects to retire or convert to natural gas its 1,053 megawatt, coal-fired Welsh Power Plant in 2028.[38]

Moreover, during the same period of time of 2014 through 2019, SWEPCO has been able to satisfy demand with other sources of fuel,[39] thus further evincing a reduction in use and thus a reduction in need to supply its coal and lignite plants under the assumption that each plant will need to operate at continuous operation for 30 days and 45 days for Dolet Hills. In fact, SWEPCO witness, Mr. Malcolm Smoak, testified that AEP recently announced a new goal to achieve net zero carbon emissions by 2050.[40] Specifically, AEP/SWEPCO plans to reduce its emissions by 80% from 2000 levels by the year 2030.[41] To implement a strategy that will achieve such a reduction, AEP has announced plans to add more than 10,000 megawatts of new renewables by 2030. In fact, even over the course of the last decade, 2011 through 2021, AEP has retired or sold more than 13,500 megawatts of coal fired generation.[42]

In an attempt to support SWEPCO's requested coal and lignite inventory levels, SWEPCO witness Mark Leskowitz asserted that SWEPCO needed its requested inventory levels because it must offer each of its coal- and lignite-fired power plants into the SPP Market. However, as Mr. Norwood testified, this condition has existed since the SPP market was initiated in 2014, and SWEPCO's energy-production levels from its coal units have trended downward for several years. Thus, the more credible evidence in the record is that it is no longer necessary for SWEPCO to maintain inventory sufficient to operate the units for 30 or 45 days of continuous operations at their full rated output. This is particularly true for Dolet Hills which has been restricted to summer month operations and scheduled for retirement no later than December 31, 2021.

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[37] HOM TR. Vol. 1 at 56:10-12.

[38] *Id* at 56:3-25.

[39] HOM TR. Vol. 3 at 751:3-8.

[40] HOM TR. Vol. 1 at 52:10-14.

[41] *Id* at 52:14-16.

[42] *Id* at 52:21-25.

Therefore, CARD urges the ALJs to reduce SWEPCO's requested coal and lignite inventory for the Flint Creek, Pirkey, Turk, and Welsh plants to approximately 617,571 tons, which would provide SWEPCO with sufficient fuel to supply 30-days of operation at the Test Year average daily-burn levels for these respective plants.[43]

CARD further urges the ALJs to disallow entirely SWEPCO's requested lignite inventory for Dolet Hills considering that plant is not likely to operate after this summer and is scheduled for retirement no later than December 31, 2021. Consequently, SWEPCO will not require fuel inventory in the future for Dolet Hills, and customers should not have to pay rates that include unrealistic coal inventory costs that ignore the fact that the plant will soon no longer be running. This adjustment disallowing entirely SWEPCO's requested lignite inventory for Dolet Hills reduces SWEPCO's requested coal and lignite inventory by approximately 1.25 million tons, and thereby reduces the associated coal and lignite inventory cost for the Company down to approximately $24.6 million, which translates to a $54.4 million reduction to SWEPCO's requested fuel inventory on a Total Company basis.[44]

B. Prepaid Pension & OPEB Assets [PO Issue 41]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

C. Accumulated Deferred Federal Income Tax [PO Issues 20]

1. Net Operating Loss ADFIT

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

2. Excess ADFIT

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

D. Accumulated Depreciation [PO Issue 12]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

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[43] CARD Exh. 3 – Norwood Dir. at 9.

[44] *Id* at 9-10.

E. Regulatory Assets and Liabilities [PO Issues 19, 21, 22, 41, 50]

1. Self-Insurance Reserve [PO Issue 19 and 40]

SWEPCO requests that it be allowed to establish a self-insurance reserve pursuant to 16 Tex. Admin. Code § 25.231(b)(1)(G). 16 TAC § 25.231(b)(1)(G) provides, in pertinent part:

> The commission will approve a self-insurance plan to the extent it finds it to be in the public interest. In order to establish that the plan is in the public interest, the *electric utility must present a cost benefit analysis* performed by a qualified independent insurance consultant who demonstrates that, *with consideration of all costs, self-insurance is a lower-cost alternative than commercial insurance* and the ratepayers will receive the benefits of the self-insurance plan. The cost benefit analysis shall present a detailed analysis of the appropriate limits of self-insurance, an analysis of the appropriate accruals to build a reserve account for self-insurance, and the level at which further accrual should be decreased or terminated.[45] [emphasis added.]

CARD urges the ALJs and Commission to reject SWEPCO's request to establish an insurance reserve because SWEPCO has not presented a cost-benefit analysis that, with consideration of *all costs*, shows that self-insurance is a lower-cost alternative than commercial insurance as the Commission's rule requires.

SWEPCO's cost-benefit analysis is deficient because it does not contain any analysis of the actual costs of commercial insurance as it does with regard to the actual costs of SWEPCO's proposed self-insurance reserve.[46] For example, SWEPCO's self-insurance reserve entails an annual accrual of $1,689,700 and a target self-insurance reserve of $3,560,000 for storm damage loss. The annual accrual is composed of two elements: 1) $799,700 to provide for average annual expected losses from storms with transmission and distribution losses of at least $500,000; and 2) $890,000 accrued over four years to achieve the target reserve of $3,560,000.[47]

In contrast to the detailed cost figures SWEPCO provided for its self-insurance reserve, SWEPCO has provided only general categories of costs of commercial insurance without ascribing any actual amounts associated with them.[48] Further, these cost categories apply to commercial

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[45] 16 Tex. Admin. Code § 25.231(b)(1)(G).

[46] CARD Exh. 2 – M. Garrett Dir. at 36.

[47] SWEPCO Exh. 28 – Direct Testimony of Gregory S. Wilson at 4 (hereinafter, "SWEPCO Exh. 28 – Wilson Dir. at __.").

[48] SWEPCO Exh. 28 – Wilson Dir. at 11; HOM TR. Vol 1 at 284:14-17 and at 288:23 – 289:3.

insurance that might be available to any utility and are not tailored to the specific facts of SWEPCO's proposed self-insurance reserve.[49] In fact, SWEPCO's witness agreed that the costs of commercial insurance would always exceed the costs of self-insurance in Texas regardless of the specifics of the self-insurance plan.[50]

SWEPCO also claims that the costs of self-insurance are lower than the actual costs of buying commercial insurance, but SWEPCO's witness was not able to recall who he spoke with to support this claim, nor is there any mention of specific insurance companies or actual dollar amounts buttressing his assertion.[51] Further, SWEPCO's witness did not know if SWEPCO had conducted any analysis at all regarding the actual costs of buying commercial insurance.[52] Finally, SWEPCO's witness admitted, that despite testifying that it was his understanding that commercial insurance continues to be "prohibitively expensive," he has not checked in three or four years to confirm whether that remains the case.[53]

SWEPCO's "cost-benefit analysis" in no meaningful way ascribes an actual cost to the cost of commercial insurance as it does with regard to the costs of its proposed self-insurance plan and on the whole lacks depth and cannot be considered to be a serious analysis of the costs of commercial insurance. As a result, neither the parties nor the ALJs and the Commission are unable to conduct an "apples-to-apples" comparison of the costs of self-insurance versus the costs of commercial insurance, avoiding the fundamental purpose of the Commission's rule: That SWEPCO present a cost-benefit analysis that demonstrates upon consideration of "all costs" that self-insurance is less costly than commercial insurance.

CARD thus urges the ALJs and the Commission to deny SWEPCO's request to implement a self-insurance reserve and deny SWEPCO's requested increase in property-insurance expense of $1,689,700.[54]

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[49] HOM TR. Vol. 1 at 285:13-18.

[50] *Id.* at 286:11-18.

[51] SWEPCO Exh. 28 – Wilson Dir. at 12; HOM TR. Vol. 1 at 290:6-15.

[52] HOM TR. Vol. 1 at 290:16-19.

[53] *Id* at 290:20 through 291:2.

[54] CARD Exh. 2 – M. Garrett Dir. at 37.

2. Hurricane Laura Costs [36, 37, 38, 39]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

III. Rate of Return [PO Issues 4, 5, 8, 9]

A. Overall Rate of Return, Return on Equity, Cost of Debt [PO Issue 8]

CARD urges the ALJs to adopt a revenue requirement that employs an overall rate of return of 6.56% as recommended by Dr. Woolridge.[55] Dr. Woolridge's proposed rate of return is based his recommended cost of equity and SWEPCO's cost of debt and capital structure shown in Table 2 below:

Table 2
CARD Rate of Return Recommendation

Capital Source	Capitalization Ratios	Cost Rate	Weighted Cost Rate
Long-Term Debt	**50.63%**	**4.18%**	**2.11%**
Common Equity	**49.37%**	**9.00%**	**4.44%**
Total Capital	**100.00%**		**6.56%**

CARD estimates that adopting Dr. Woolridge's proposed return on equity ("ROE") of 9.00% with a capital structure of 50.63% long-term debt and 49.37% common equity, reduces SWEPCO's proposed total increase of approximately $105 million in revenue by approximately $13.4 million.[56]

1. Return on Equity

a. Overview

In setting a utility's rates, the return on equity ("ROE") is the allowed rate of profit the regulatory authority determines a regulated company is allowed the opportunity to earn.[57] The

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[55] CARD Exh. 4 – Direct Testimony and Exhibits of J. Randall Woolridge, Ph.D. at 4 (hereinafter, "CARD Exh. 4 – Woolridge Dir. at __.").

[56] *See* CARD Exh. 6 –Nalepa Dir. at 4.

[57] CARD Exh. 4 – Woolridge Dir. at 2.

ROE is a component of a utility's overall rate of return.[58] PURA mandates that a utility like SWEPCO be allowed a reasonable *opportunity to earn* a reasonable return on its invested capital used and useful in providing service to the public, above its reasonable and necessary expenses.[59] Thus, while often the conversation surrounding a utility's return is that it did not earn its authorized return, or even perhaps that a utility is guaranteed a certain level of profit, the plain language of PURA dictates otherwise: A utility is to be provided a reasonable *opportunity to earn* a reasonable return.

As a substitute for competition,[60] the Commission's role is not to guarantee a utility its authorized return; like a business in a competitive market, SWEPCO must earn its return. Given that the Commission serves as a substitute for competition, the return the Commission establishes likewise is not guaranteed. Instead the Commission need do no more or no less, than to establish SWEPCO's overall revenue at a level that will allow it a reasonable opportunity to earn a reasonable return over its reasonable and necessary expenses.[61]

In two cases, *Hope* and *Bluefield*,[62] the United States Supreme Court established the guiding principles for determining an appropriate level of profitability for regulated public utilities. In those cases, the Court recognized that the fair rate of return on equity should be: (1) comparable to returns investors expect to earn on other investments of similar risk; (2) sufficient to assure confidence in the company's financial integrity; and (3) adequate to maintain and support the company's credit and to attract capital.[63] All cost-of-capital witnesses in this proceeding cite to *Hope* and *Bluefield* as a guide in their respective proposals.

Unlike determining a utility's cost of debt, to determine the cost of equity, the ALJs and the Commission must turn to economic models and formulas to estimate the cost of equity. Using

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[58] CARD Exh. 4 – Woolridge Dir. at 4; *see also* Dr. Woolridge's discussion at CARD Exh. 4 – Woolridge Dir. at 21-22.

[59] PURA § 36.051.

[60] PURA § 11.002(b).

[61] *See* PURA § 36.051.

[62] *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) ("*Hope*") and *Bluefield Water Works and Improvement Co. v Public Service Commission of West Virginia*, 262 U.S. 679 (1923) ("*Bluefield*").

[63] CARD Exh. 4 – Woolridge Dir. at 2.

market data of similar-risk firms these models are intended to estimate the ROE investors require for that risk-class of firms in order to set an appropriate ROE for a regulated firm [64]

b. Return on Equity

For ease of comparison, CARD below sets forth each party's recommendation regarding SWEPCO's cost of equity:

	CARD	TIEC	PUCT STAFF	SWEPCO
Return on Equity	**9.00%**	**9.15%**	**9.225%***	**10.35%**

- *Includes a 12 5 basis point downward adjustment as proposed by Staff Witness Poole for poor quality of service and management*

In this proceeding, through the testimonies of Mr. Dylan W. D'Ascendis and Ms. Renee V. Hawkins,[65] SWEPCO has proposed a capital structure of 50.63% long-term debt and 49.37% equity; a cost of long-term debt of 4.18%; and a cost of equity of 10.35%, resulting in an overall rate of return of 7.22%.[66]

CARD urges the ALJs to reject Mr. D'Ascendis' recommendations regarding the cost of equity and instead to adopt a revenue requirement that employs a cost of equity of 9.00% as recommended by Dr. Woolridge.[67] Dr. Woolridge primarily relied on the Discounted Cash Flow ("DCF") Model for his recommended cost of equity.[68]

Based on the DCF Model ("DCF"), Dr. Woolridge's DCF analysis suggests a cost of equity of 9.15% (based on his Electric Proxy Group) and 9.00% (based on Mr. D'Ascendis' Proxy Group).[69] Dr. Woolridge's CAPM analysis suggests a cost of equity of 7.60% for both his Electric Proxy Group and Mr. D'Ascendis' Proxy Group.[70]

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64 *Id* at 2-3; 28.

65 *See* SWEPCO Exh. 8 – Direct Testimony of Dylan W. Ascendis at 5 (hereinafter, "SWEPCO Exh. 8 – D'Ascendis Dir. at __."); and SWEPCO Exh. 9 – Direct Testimony of Renee Hawkins at 3 (hereinafter, "SWEPCO Exh. 9 – Hawkins Dir. at __.").

66 *Id.* at 3.

67 CARD Exh. 4 – Woolridge Dir at 4.

68 *Id* at 4; 28; 54.

69 *Id* at 41.

70 *Id* at 53-54.

Dr. Woolridge concludes that the appropriate equity-cost rate is in the range of 7.60% to 9.15% range for the companies in the Electric Proxy Group and in Mr. D'Ascendis' Proxy Group. Because Dr. Woolridge relies primarily on the DCF model, he concludes that the appropriate equity-cost rate for SWEPCO is 9.0%, the upper end of Dr. Woolridge's range for the equity-cost rate.[71]

i. Capital Market Conditions

(a) Declining Authorized ROEs

Dr. Woolridge's testimony established two key points in determining a ROE for SWEPCO. First, across the Nation, the trend in authorized ROEs that regulatory agencies have been approving, is downward.[72] The uncontroverted evidence established that from about 2012 to 2020, authorized ROEs for electric utilities have declined as shown in the table below.[73]

Year	Average ROE
2012	10.01%
2013	9.80%
2014	9.76%
2015	9.58%
2016	9.60%
2017	9.68%
2018	9.58%
2019	9.65%
2020	9.39%

Additionally, since about 2008, yields on A-rated public-utility bonds have gradually declined in the past decade from 7.5% to the 3.0% range with a slight increase since the middle of 2020 to the 3.5% range, bottoming out at 3.1% in 2019.[74]

Finally, earned returns on common equity for publicly-traded electric utilities have declined gradually over the years. In the past five years, the average earned ROE for publicly-

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[71] *Id.* at 54-55.

[72] *Id.* at 15-16.

[73] *Id* at 13.

[74] *Id* at 7; and Exhibit JRW-2 at p. 2.

traded electric utilities has been in the 9.0%-to-10.0% range.[75] The average market-to-book ratios for publicly-traded electric utilities increased over the past decade peaking at 2.0X in 2019, and declined to 1.75X in 2020. A market-to-book ratio greater than 1.0X means that returns on common equity are greater than the cost of capital.[76] As Dr. Woolridge's testimony established, electric utilities' returns on equity have exceeded a factor of 1X for many years, and as such are more than necessary to meet investors' required returns. [77] Returns in excess of those needed to meet investors' requirements means that customers are paying more than necessary to support an appropriate profit level for regulated utilities.[78]

(b) Stable to declining interest rates

Second, interest rates remained at historically low levels and are likely to remain low for some time.[79] Interest rates increased marginally from about 2016 to 2018 to about 2.10%, declined to slightly above 1% in mid-2020, and increased to about 2.25% in early 2021. All in all, however, interest rates and capital costs have remained at historically low levels.[80] Nonetheless, Mr. D'Ascendis' analyses and ROE results and recommendations continue to reflect the assumption of higher interest rates and capital costs.

With regard to interest rates, as Dr. Woolridge noted, economists continue to forecast higher interest rates, as does Mr. D'Ascendis, a prediction that continues in its inaccuracy.[81] And the error in predicting higher interest rates infects Mr. D'Ascendis' proposed cost of equity capital.[82] As Dr. Woolridge explained:

> Mr. D'Ascendis' analyses, ROE results, and recommendations are based on assumptions of higher interest rates and capital costs. However, despite the recent rise in rates, interest rates and capital costs remain at historically low levels. In 2019, interest rates fell due to slow economic growth and low inflation. Interest

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75 *Id.* at Exhibit JRW-2 at p. 3.

76 *Id* at 25-26.

77 *Id.*

78 *See* PURA § 36.051 ("... the regulatory authority shall establish the utility's overall revenues at an amount that will permit the utility a reasonable opportunity to earn a reasonable return on the utility's invested capital used and useful in providing service to the public ... .").

79 CARD Exh. 4 – Woolridge Dir. at 5, 9, 55, and 57.

80 *Id*

81 HOM TR Vol. 4 at 1003:11 – 1004; 19; and at 1005:15 – 1006:13.

82 HOM TR. Vol. 4 at 1003:22 – 1004:19.

> rates fell even further to record low levels in 2020 due to the impact of the novel coronavirus on the world's population and economy. The benchmark 30-year Treasury yield has rebounded since mid-2020, but it is in the 2.25% range.[83]

The record establishes not only the fallacy of Mr. D'Ascendis' inflated proposed return on equity ("ROE"), but the validity of Dr. Woolridge's conclusion that Wall Street's projections of interest rates and ROEs are upwardly biased. In only one case in which Mr. D'Ascendis presented cost-of-capital testimony in the past five years was his recommendation in line with what the regulatory agency approved, and that case involved a water utility.[84] In all other cases, Mr. D'Ascendis' specific proposed ROE was consistently higher than the regulatory agency approved, and in several instances, even his low-to-high range of ROEs was above the ROE the regulatory agency approved, perpetuating the bias Dr. Woolridge identifies, not only in Mr. D'Ascendis' testimony, but in Wall Street's projections, too.[85] As Dr. Woolridge testified at the hearing:

> As I mentioned in my testimony, I mean, an economist's forecasts of interest rates aren't very good. I cite a couple of studies that deal with that. And I think commissions have been impacted by saying, well, using these projected interest rates like in this case, you have high CAPM and high risk premium because you're using projected interest rates, not the current interest rate. And I think commissions have believed this idea – you know, economists have been saying interest rates are going up for a decade, and they haven't, they've been wrong. And so ... I think commissions believe, to some degree – they look at this testimony and they incorporate those projections of higher interest rates, and that's why I think ROEs have actually ... been inflated because, you know, ... we haven't seen interest rates of 5 percent like a lot of models would – you know, projections were four or five years ago for 30-year Treasury yields.[86]

Further, when directly asked on cross-examination whether the increase in 30-year Treasury yields to about 2.3% leads to a ROE higher than 9.45%,[87] Dr. Woolridge rejected the notion, and stated:

> No, I disagree. If you look last year, as I said, the 30-year Treasury went from about 2.25 percent, and within two months – it bottomed at 1.25. That was a two-

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[83] CARD Exh. 4 – Woolridge Dir. at 5.

[84] CARD Exh. 28 at 2 (regarding the ROE for Carolina Water Service, Inc. in 2018).

[85] CARD Exh. 4 – Woolridge Dir. at 5, 36-38, 40, 58-59, 60, and 68.

[86] HOM TR. Vol. 4 at 1004:3-21.

[87] The ROE of 9.45% is the ROE the Commission approved in Docket No. 49831 for Southwestern Public Service Company. *See* HOM TR. Vol 4 at 996:5-6.

> month time frame. Since that time it's been coming up. But overall if you say in 2020 the 30-year Treasury yield declined about 100 basis points, 2.25 to 1.25. If you look at the average authorized ROE in 2020 for electric utilities, it declined about 20 basis points. So authorized ROEs never declined as low as interest rates. There's not a one-to-one relationship between authorized ROEs and 30-year Treasury yields. And so last year the authorized ROEs declined about 20 basis points, interest rates went back down 100 basis. So the authorized ROEs never reflected on a one-to-one basis on that big drop in interest rates.[88]

Consequently, CARD urges the ALJs to reject Mr. D'Ascendis' proposed ROE because it is flawed, by among other factors, his reliance on non-existent increases in interest rates leading to his inflated ROEs firmly rejected in his prior 5 years' of testimonies.[89] In short, Mr. D'Ascendis' analyses, ROE results, and recommendations are based on assumptions of higher interest rates and capital costs which have not come to and are not likely to come to pass and his analyses ignores more realistic market conditions.[90]

Thus, for purposes of setting SWEPCO's cost of equity in this proceeding, the more credible evidence in the record on cost of capital is that of Dr. Woolridge. Therefore, CARD urges the ALJs to set SWEPCO's cost of equity.

ii. Proxy Groups

Dr. Woolridge and Mr. D'Ascendis each based their respective recommended ROEs in part on proxy companies for SWEPCO. Dr. Woolridge's "Electric Proxy Group" is comprised of 27 companies that Dr. Woolridge found comparable to SWEPCO.[91] Mr. D'Ascendis' Proxy Group is made up of only 13 utilities.[92] The financial metrics of the companies in Dr. Woolridge's Electric Proxy Group and those in Mr. D'Ascendis' Proxy Group show that the riskiness of the two proxy groups using five different risk measures published by *Value Line* – Beta, Financial

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88 HOM TR. Vol. 4 at 996:20 - 997:15.

89 Indeed, Mr. D'Ascendis' proposed ROE is higher than any ROE the Commission has authorized for any electric utility in Texas, whether fully-integrated or a transmission and distribution utility ("TDU"). Table 3 in Dr. Woolridge's testimony shows the highest ROE the Commission authorized in the past 10 years to be 10.25%; yet, Mr. D'Ascendis proposes a ROE of 10.35%. CARD Exh. 4 – Woolridge Dir. at 19.

90 CARD Exh. 4 – Woolridge Dir. at 5, 36-38, 40, 58-59, 60, and 68.

91 *Id.* at 16-17 and Exhibit JRW-3.

92 *Id.*

Strength, Safety, Earnings Predictability, and Stock Price Stability – suggest that the two proxy groups are very similar in risk as indicated by the mean value for each of the five risk measures:[93]

	Beta	Financial Strength	Safety	Earnings Predictability	Stock Price Stability
Electric Proxy Group	.87	A	1.8	83	89
D'Ascendis Proxy Group	.88	A	2.0	83	92

Either Dr. Woolridge's Electric Proxy Group or Mr. D'Ascendis' Proxy Group establishes that the investment risk associated with investing in SWEPCO is very low relative to the overall stock market and that investing in SWEPCO presents a similar risk to the average of the two proxy groups.[94]

Further, the evidence establishes that SWEPCO is similar in risk to the companies identified in the two proxy groups:

> I believe that bond ratings provide a good assessment of the investment risk of a company. Page 1 of Exhibit JRW-3 also shows S&P and Moody's issuer credit ratings for the companies in the two groups. The average S&P and Moody's ratings for the two groups are BBB+ and Baa1. SWEPCO's issuer credit rating is A- according to S&P and Baa2 according to Moody's. As such, SWEPCO's S&P rating is one notch above the average of the two proxy groups, and SWEPCO's Moody's rating is one notch below the average of the two proxy groups. On balance, I believe that this comparison suggests that SWEPCO investment risk level is similar to the average of the two proxy groups.[95]

Mr. D'Ascendis also presents testimony in effect equating a group of non-price regulated companies to SWEPCO.[96] However, the evidence does not support use of Mr. D'Ascendis' non-price regulated companies to estimate the cost of SWEPCO's cost of equity capital. On its face, the comparison is farcical and CARD urges the ALJs to give no countenance to such a comparison and to reject Mr. D'Ascendis' reference to his list of non-price regulated companies as nothing more than an effort to further inflate his recommendation regarding SWEPCO's ROE.

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[93] *Id.* at 18.

[94] *Id.* at 17-18.

[95] *Id.* at 17.

[96] SWEPCO Exh. 8 – D' Ascendis Dir. at 48-51.

iii. DCF Model Results

Dr. Woolridge relied primarily on his DCF analysis to estimate SWEPCO's cost of equity and employed the "constant-growth" DCF model to estimate SWEPCO's cost of equity.[97] Dr. Woolridge testified that the DCF Model is used widely by investment firms.[98] He describes the DCF model as one that postulates that the current stock price is equal to the discounted value of all future dividends that investors expect to receive from investment in the firm. As such, stockholders' returns ultimately result from current as well as future dividends.[99] "The DCF model presumes that earnings that are not paid out in the form of dividends are reinvested in the firm to provide for future growth in earnings and dividends. The rate at which investors discount future dividends, which reflects the timing and riskiness of the expected cash flows, is interpreted as the market's expected or required return on the common stock. Therefore, this discount rate represents the cost of common equity."[100]

Based on his analysis, Dr. Woolridge calculated the dividend yields for the companies in proxy groups using the current annual dividend and the 30-day, 90-day, and 180-day average stock prices.[101] Using both the means and medians, the dividend yields range from 3.7% to 3.9% for the Dr. Woolridge's Electric Proxy Group; Dr. Woolridge used a dividend yield of 30,8% for his Electric Proxy Group. The dividend yield for Mr. D'Ascendis' proxy group shows dividend yields of 3.9% to 4.0%.[102]

Dr. Woolridge next adjusted the dividend yield by one-half (1/2) of the expected growth to reflect growth over the coming year.[103] For his growth rate, Dr. Woolridge reviewed *Value Line's* historical and projected growth rate estimates for earnings per share ("EPS"), dividends per share

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97 CARD Exh. 4 – Woolridge Dir. at 28, 57, and 85.

98 Dr. Woolridge describes the DCF model in his testimony generally at CARD Exh. 4. – Woolridge Dir. at 29:4 – 32:10.

99 CARD Exh. 4 – Woolridge Dir. at 29.

100 *Id.*

101 *Id* at 32; Exhibit JRW-7 at 2.

102 *Id.*

103 *Id.* at 32-33.

("DPS"), and book value per share ("BVPS"). He utilized the average EPS growth rate forecasts of Wall Street analysts as provided by Yahoo, Reuters and Zacks.[104]

Lastly, he assessed prospective growth as measured by prospective earnings retention rates and earned returns on common equity.[105] Dr. Woolridge testified that in the DCF Model, the growth rate is the long-term projected growth rate in EPS, DPS, and BVPS. Therefore, in developing an equity cost rate using the DCF model, the projected long-term growth rate is the projection used in the DCF model,[106] and warned against relying exclusively on EPS forecasts prepared by Wall Street analysts in identifying a DCF growth rate.

> First, the appropriate growth rate in the DCF model is the dividend growth rate, not the earnings growth rate. Nonetheless, over the very long term, dividend and earnings will have to grow at a similar growth rate. Therefore, consideration must be given to other indicators of growth, including prospective dividend growth, internal growth, as well as projected earnings growth. Second, a study by Lacina, Lee, and Xu (2011) has shown that analysts' three-to-five year EPS growth-rate forecasts are not more accurate at forecasting future earnings than naïve random walk forecasts of future earnings. ... Finally, and most significantly, it is well known that the long-term EPS growth-rate forecasts of Wall Street securities analysts are overly optimistic and upwardly biased. This has been demonstrated in a number of academic studies over the years. ... Hence, using these growth rates as a DCF growth rate will provide an overstated equity cost rate. On this issue, a study by Easton and Sommers (2007) found that optimism in analysts' growth rate forecasts leads to an upward bias in estimates of the cost of equity capital of almost 3.0 percentage points.[107]

Though SWEPCO takes exception to Dr. Woolridge's conclusion that Wall Street analysts' forecasts of growth are upwardly biased, the data Dr. Woolridge presented establishes the upward bias.[108] In fact, Dr. Woolridge presented the results of a study he performed comparing forecasted versus actual long-term EPS growth rates over the 1985-2020 time period. He found that over the entire time period, the mean forecasted EPS growth rate was over 200 basis points above the actual EPS growth rate for utilities. Dr. Woolridge's study stands unrefuted in the record evidence. The

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[104] *Id* at 33-34.

[105] *Id* at 34.

[106] *Id*

[107] *Id* at 36.

[108] *Id.* at 36-38.

upward bias in analysts' long-term EPS growth rate forecasts is in turn reflected in stock prices.[109] More importantly, because in the DCF Model the equity cost rate is a function of the dividend yield and expected growth rate, Dr. Woolridge adjusted the DCF growth rate downward from the projected EPS growth rate to reflect the upward bias in the DCF model.[110]

Dr. Woolridge's analysis reviewed the 5- and 10-year *historical* growth rates of the companies in his Electric Proxy Group and Mr. D'Ascendis' Proxy Group; the *projected* growth rates as shown by Value Line for the two proxy groups; and reviewed the proxy-group companies as measured by analysts forecasts of expected 5-year growth in earnings per share.[111] For the *historical* growth rates for the companies in his Electric Proxy Group and in Mr. D'Ascendis' Proxy Group, Dr. Woolridge found the median historical growth measures for EPS, DPS, and BVPS for the Electric Proxy Group to range from 4.0% to 5.5%, with an average of the medians of 4.8%.[112] For the D'Ascendis Proxy Group the historical growth measures in EPS, DPS, and BVPS, as measured by the medians, also ranged from 4.0% to 5.5%, with an average of the medians of 4.4%.[113]

For Dr. Woolridge's *projected* growth rates for his Electric Proxy Group, his analysis found the medians ranged from 4.0% to 5.0%, with an average of the medians of 5.0%. The range of the medians for the D'Ascendis Proxy Group were from 4.0% to 4.4%, with an average of the medians of 4.8%.[114]

In terms of a sustainable growth rate, Dr. Woolridge found the median prospective sustainable growth rates for the Electric and D'Ascendis Proxy Groups, to be 3.7% and 3.9%, respectively.[115]

Finally, for the proxy-groups companies as measured by analysts' forecasts of expected 5-year growth in earnings per share, Dr. Woolridge's analysis determined the mean/median of analysts' projected EPS growth rates for the Electric and D'Ascendis Proxy Groups to be

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[109] *Id.* at 38.

[110] *Id.*

[111] *Id.* at 38-40.

[112] *Id* at 38.

[113] *Id.* at 38-39.

[114] *Id.* at 39.

[115] *Id.*

5.5%/5.8% and 5.4%/5.3%, respectively.[116] Exhibit JRW-7 shows the summary DCF growth rate indicators for the proxy groups.[117]

Electric and D'Ascendis Proxy Groups

Growth Rate Indicator	Electric Proxy Group	D'Ascendis Proxy Group
Historic *Value Line* Growth in EPS, DPS, and BVPS	**4.8%**	**4.4%**
Projected *Value Line* Growth in EPS, DPS, and BVPS	**5.0%**	**4.8%**
Sustainable Growth ROE * Retention Rate	**3.7%**	**3.9%**
Projected EPS Growth from Yahoo and Zacks - Mean/Median	**5.5%/5.8%**	**5.4%/5.3%**

Based on his analysis, Dr. Woolridge concluded that his DCF analysis suggested a cost of equity of 9.15% (based on the growth rates for his Electric Proxy Group) and 9.00% (based on the growth rates for Mr. D'Ascendis's Proxy Group).[118] Dr. Woolridge's findings are summarized in Table 4, below:

Table 4

DCF-Derived Equity Cost Rate/ROE[119]

	Dividend Yield	1 + ½ Growth Adjustment	DCF Growth Rate	Equity Cost Rate
Electric Proxy Group	**3.80%**	**1.0265**	**5.25%**	**9.15%**
D'Ascendis Proxy Group	**3.90%**	**1.0265**	**5.00%**	**9.00%**

[116] *Id* at 39-40.

[117] *Id.* at Exhibit JRW-7 at p. 6.

[118] *Id* at 41.

[119] *Id* at Exhibit JRW-7 at 1.

iv. CAPM Model

Dr. Woolridge also employed the Capital Asset Pricing Model ("CAPM") to estimate SWEPCO's cost of equity.[120] The CAPM Model is a risk premium approach to gauging a firm's cost of equity capital.[121] According to the risk premium approach, the cost of equity is the sum of the interest rate on a risk-free bond (shown as R_f) and a risk premium (RP).[122] The yield on long-term U.S. Treasury securities is normally used as the risk-free investment (R_f); and in the CAPM Model the risk measured is the risk associated with owning common stock in a company.[123]

There are two types of risk associated with a stock: firm-specific risk or unsystematic risk, and market or systematic risk, which is measured by a firm's beta. The only risk that investors receive a return for bearing is systematic risk.[124] To estimate the required return or cost of equity using the CAPM requires three inputs: the risk-free rate of interest (R_f), the beta (ß), and the expected equity or market risk premium $[E(R_m) - (R_f)]$.[125]

With regard to the first factor, the interest rate on a risk free bond, using the CAPM Model, Dr. Woolridge's analysis found the yield on 30-year U.S. Treasury bonds to be in the 1.25% to 4.75% range over the 2010–2021 period; he also found that the current 30-year Treasury yield is near the middle of this range.[126] Given the recent range of yields, he elected to use the middle of the range as his risk-free interest rate, employing 2.50% as the risk-free rate, or R_f, in his CAPM analysis.[127] Crucially, his CAPM analysis excludes forecasts of higher interest rates because as he observed, forecasts of interest rates have been notoriously wrong for a decade.[128]

For the beta (ß) input, Dr. Woolridge explained that beta is a measure of the systematic risk of a stock.[129] He explained that the market, usually taken to be the S&P 500, has a beta of 1.0.

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[120] *Id.* at 41. Dr. Woolridge describes the CAPM model at CARD Exh. 4 – Woolridge Dir. at 41-42.

[121] CARD Exh. 4 – Woolridge Dir. at 41.

[122] *Id.*

[123] *Id.*

[124] *Id.* at 41-42.

[125] *Id.* at 42.

[126] *Id* at 43.

[127] *Id.*

[128] *Id.*

[129] *Id.*

The beta of a stock with the same price movement as the market also has a beta of 1.0. A stock whose price movement is greater than that of the market, such as a technology stock, is riskier than the market and has a beta greater than 1.0.[130] A stock with below average price movement, such as that of a regulated public utility like SWEPCO, is less risky than the market and has a beta less than 1.0.[131] Dr. Woolridge concluded that the median betas for the companies in his Electric Proxy Group and Mr. D'Ascendis' Proxy Group are 0.85,[132] suggesting that the companies in the proxy groups are less risky than the overall market. Likewise, given that no party disputed the comparability of the proxy-group companies to SWEPCO,[133] its beta is below a beta of 1.0 and thus is less risky than the overall market.

For the market-risk-premium ("MRP") input into his CAPM analysis, Dr. Woolridge first explained that the MRP is equal to the expected return on the stock, minus the risk-free rate of interest.[134] Dr. Woolridge explained that the MRP is the difference in the expected total return between investing in equities and investing in "safe" fixed-income assets, such as long-term government bonds.[135]

Ultimately, based on his CAPM analysis, Dr. Woolridge presented a summary of the results of the MRP studies he reviewed, including the results of: (1) the various studies of the historical risk premium, (2) *ex ante* MRP studies, (3) MRP surveys of CFOs, financial forecasters, analysts, companies and academics, and (4) the Building Blocks approach to the MRP.[136] His analysis found the median MRP to be 4.83% for over 30 studies using these approaches.[137] However, these studies covered the period over the past 15 years and included the financial crisis of 2008, and the data for the early 2000s, when the market peaked.[138]

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[130] *Id.*

[131] *Id.*

[132] *Id.* at 47; Exhibit JRW-8.

[133] *Id* at 55.

[134] *Id.* at 47.

[135] *Id.*

[136] *Id.* at 47-49.

[137] *Id.* at 50.

[138] *Id*

Because the studies of MRPs Dr. Woolridge reviewed were published prior to the financial crisis that began in 2008 and some of the studies were published in the early 2000s at the market peak, and further because many of these studies used data over long periods of time (as long as 50 years of data) and thus were not estimating a market-risk premium as of a specific point in time (e.g., the year 2001), Dr. Woolridge eliminated all studies dated before January 2, 2010.[139] The median market-risk-premium estimate for this subset of studies is 5.13%.[140]

Dr. Woolridge's assessment of MRP studies and surveys showed the following:

> **Historic Stock and Bond Returns** - Historic stock and bond returns suggest an MRP in the 4.40% to 6.43% range, depending on whether one uses arithmetic or geometric mean returns.
>
> **Ex Ante Models** - MRP studies that use expected or ex ante return models, indicates MRPs in the range of 5.24% to 6.75%.
>
> **Surveys** - MRPs developed from surveys of analysts, companies, financial professionals, and academics find lower MRPs, with a range from 3.36% to 5.70%.[141]

In light of his analysis, Dr. Woolridge concluded that the appropriate MRP in the U.S. is in the 4.0% to 6.0% range.[142] Dr. Woolridge used an expected MRP of 6.00%, which is in the upper end of the range, as the MRP. He gave most weight to the MRP estimates of Duff & Phelps, KPMG, the Fernandez survey, and Damodaran.[143]

Based on his CAPM analysis, Dr. Woolridge found SWEPCO's cost of equity to be 7.6% for both his Electric Proxy Group and for Mr. D'Ascendis' Proxy Group.[144] Dr. Woolridge's CAPM results are summarized in Table 5, below:

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[139] *Id* at 50; Exhibit JRW-8 at p. 6.

[140] *Id*

[141] *Id.* at 50-51.

[142] *Id* at 53; Exhibit JRW-8 at p. 6.

[143] *Id* at 53.

[144] *Id* at 54.

Table 5
CAPM-Derived Equity Cost Rate/ROE[145]
$K = (R_f) + ß * [E(R_m) - (R_f)]$

	Risk-Free Rate	Beta	Equity Risk Premium	Equity Cost Rate
Electric Proxy Group	**2.50%**	**0.85**	**6.0%**	**7.6%**
D'Ascendis Proxy Group	**2.50%**	**0.85**	**6.0%**	**7.6%**

Dr. Woolridge's Recommended ROE

Ultimately, Dr. Woolridge's analysis suggested a cost of equity in the range of 7.60% (CAPM) to 9.15% (DCF) for the companies in Electric Proxy Group and in the D'Ascendis Proxy Group. But because he relied primarily on his DCF model to estimate SWEPCO's cost of equity capital, Dr. Woolridge recommends a cost of equity of 9.00%, which is in the upper end of his range of cost of equity capital.[146]

Moreover, as Dr. Woolridge noted, the credit-rating agency, Moody's, recognized that even with lower authorized ROEs, electric utilities were earning ROEs of 9.0% to 10.0%, and their credit profiles were not being impaired and they were undeterred from raising record amounts of capital.[147] Further, Moody's also recognized that utilities and regulatory commissions were "struggling" to justify higher ROEs in the face of lower interest rates and risk-reducing, cost-recovery mechanisms like the Distribution Cost Recovery Factor ("DCRF"), the Transmission Cost Recovery Factor ("TCRF"), the Purchased Power Cost Recovery Factor ("PCRF"), and finally the Generation Cost Recovery Factor ("GCRF"), all of which are available to SWEPCO.[148]

A cost of equity of 9.00% is fully supported by the record and meets the standards of *Hope* and *Bluefield*. As Dr. Woolridge noted:

1. Capital costs for utilities, as indicated by long-term, utility-bond yields, are still at historically low levels;
2. Given low inflationary expectations and slow global economic growth, interest rates are likely to remain at low levels for some time;

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[145] *Id.*

[146] *Id.* at 54.

[147] *Id* at 56.

[148] *Id. See* PURA § 36.210 (DCRF), PURA § 39.905(b) (EECRF), PURA § 36.205 (PCRF), PURA § 36.209 (TCRF), and PURA § 36.213 (GCRF).

3. The electric utility industry are among the lowest risk industries in the U.S. as measured by beta. As such, the cost of equity capital for this industry is the lowest in the U.S., according to the CAPM;
4. The Company's proposed capital structure, which Dr. Woolridge accepted, incorporates a higher common-equity ratio and lower financial risk than the averages of the three proxy groups;
5. The investment risk of SWEPCO is in line with the Electric Proxy Group and the D'Ascendis Proxy Group, as indicated by the Company's S&P issuer credit rating; and
6. Dr. Woolridge's recommended equity-cost rate lies at the high end of the range his analysis established for a fair ROE.[149]

Therefore, CARD urges the ALJs to recommend a cost of equity capital of 9.00% for SWEPCO.

v. Critique of Mr. D'Ascendis' ROE Recommendations

Dr. Woolridge found numerous flaws in Mr. D'Ascendis' analysis and recommendations regarding the cost of equity for SWEPCO.

a. Capital Market Conditions

Critically, Mr. D'Ascendis provides no details on how he weighted his equity cost-rate results to arrive at his recommended ROE of 10.35%. Beyond the narrow view Mr. D'Ascendis undertook in his CAPM analysis, Mr. D'Ascendis' analyses ignore capital market conditions and are based on assumptions of higher interest rates and capital costs. But as Dr. Woolridge's testimony established, despite the recent rise in rates, interest rates and capital costs remain at historically low levels.[150]

In 2019, interest rates fell due to slow economic growth and low inflation. Interest rates fell even further to record low levels in 2020 due to the impact of the novel coronavirus on the world's population and economy. The benchmark 30-year Treasury yield has rebounded since mid-2020, but it is in the 2.25% range.[151] The whole of Mr. D'Ascendis' analysis is infected by this upward bias in estimating cost of equity capital.

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[149] *Id.* at 55.

[150] *Id.* at 12.

[151] *Id.* at 57.

b. D'Ascendis' DCF Analysis

Mr. D'Ascendis seemingly gives very little, if any, weight to his DCF results. His mean DCF result for his proxy group is 8.73%, yet, his overall recommendation is 167 basis points higher at 10.35%. Though Mr. D'Ascendis attempted to respond to Dr. Woolridge's criticism on this point, his explanation raised more questions than provided answers.[152] And nowhere does he expressly state which, if any, of his methods for estimating SWEPCO's cost of equity is more or less, impactful.

Had Mr. D'Ascendis given his resulting 8.63% any weight, he would have arrived at a much lower recommendation for his estimated cost of equity. Mr. D'Ascendis states that the indicated range of equity cost rate is 9.85% to 10.96% (which has a midpoint of 10.41%). This range excludes his size and credit risk adjustments of 0.20% and 0.27%, respectively. Had he included the lower end of his range, a cost of equity capital of 8.73%, his indicated range would have been 8.73% to 10.96% (which has midpoint 9.85%).[153]

Additionally, Mr. D'Ascendis relies exclusively on Wall Street analysts' and *Value Line*'s forecasts of growth rates in earnings-per-share ("EPS"), which, as Dr. Woolridge established, produce overly-optimistic and upwardly-biased results.[154] Moreover, it is not likely that investors today rely exclusively on the EPS growth-rate forecasts of Wall Street analysts and *Value Line* to the exclusion of other growth-rate measures in arriving at their expected growth rates for equity investments. Further, as Dr. Woolridge testified, the appropriate growth rate in the DCF model is the dividend growth rate rather than the earnings growth rate.

Thus, in determining SWEPCO's ROE, and serving as a substitute for competition, it is necessary to give consideration to other indicators of growth, including historical and prospective dividend growth, internal growth, and projected earnings growth. In light of the inaccuracy of analysts' long-term-earnings, growth-rate forecasts, the ALJs should give limited weight to analysts' projected EPS growth rates; beyond being inaccurate the credible evidence shows them

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[152] *See* HOM TR. Vol. 4 at 934:8 – 936:8; and 953:15 – 954:6.

[153] CARD Exh. 4 – Woolridge Dir. at 60.

[154] *Id.* at 35-38 and 60-61.

to consistently be overly optimistic and upwardly biased.[155] Using these growth rates as a DCF growth rate, as Mr. D'Ascendis did, produces an overstated equity-cost rate.

c. Risk Premium Approach

The risk-premium model for estimating the cost of equity capital posits that the sum of the base interest-rate yield plus a risk premium results in the cost of equity capital. Based on his risk-premium model, Mr. D'Ascendis estimates a cost of equity capital of 10.54%, which is the average of his two risk-premium analyses: His Predictive Risk Premium Model ("PRPM"), which produces an estimated ROE of 10.27%, and his Adjusted Total-Market Model ("ATMM") through which he estimates a ROE of 10.80%.[156] In turn, the results of his PRPM approach are premised on a risk-free rate of 2.09% plus a risk premium of 8.24%. His ATMM approach is premised on a projected bond yield for Aaa-rated of 3.03% plus an equity risk premium of 7.02%.[157]

Seemingly, Mr. D'Ascendis estimated his market risk premium using six different approaches. However, in reality, he presents two tactics to estimate the market risk premium. Of the six approaches he lists, one-half of them are based on the same *historical* stock and bond returns, and the other half rely on the same *projected* market data of Aaa-rated companies.[158] More crucially, Mr. D'Ascendis' principal error in his Risk Premium Method ("RPM") is in the magnitude of the risk premiums he presents that are based on historical and projected stock- and bond-market returns.[159]

The inputs to Mr. D'Ascendis' PRPM method are the historical returns on the common shares of each company in the proxy group less the historical monthly yield on long-term U.S. Treasury securities for some undefined period.[160] His PRPM results show a wide range in equity-cost rates ranging from a low of 7.62% for Ameren to a high of 13.38% for Entergy. The average of the mean and median estimates is return of 10.27%.[161]

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[155] *See* CARD Exh. 4 – Woolridge Dir. at 41-45 at Footnotes 15-17.

[156] *Id* at 61.

[157] *Id*

[158] *Id.*

[159] *Id.*

[160] *Id.*

[161] *Id.*

Mr. Ascendis' PRPM approach suffers from two fundamental flaws. First, it is based on the historical relationship between stock and bond returns.[162] His PRPM and risk-premium studies (1)-(3)[163] are based on historical stock and bond returns/yields. As Dr. Woolridge testified:

> It is well-known and well-studied that using historical returns to measure an *ex ante* equity risk premium is erroneous and overstates the true market or equity risk premium. ... This approach can produce differing results depending on several factors, including the measure of central tendency used, the time period evaluated, and the stock-market index employed.
>
> In addition, there are a myriad of empirical problems in the approach, which result in historical market returns producing inflated estimates of expected risk premiums. Among the errors are the U.S. stock market survivorship bias (the "Peso Problem"); the company survivorship bias (only successful companies survive – poor companies do not survive); the measurement of central tendency (the arithmetic versus geometric mean, where geometric means tend to better capture negative returns and thus investor loss); the historical time horizon used; the change in risk and required return over time; the downward bias in bond historical returns; and unattainable return bias (the return computation procedure presumes monthly portfolio rebalancing).[164]

The very source Mr. D'Ascendis relied upon,[165] Duff & Phelps, a respected financial firm is also critical of Mr. D'Ascendis' approach cautioning against using historical returns to compute an equity risk premium ("ERP") noting that, "In estimating the conditional ERP, valuation analysts cannot simply use the long-term historical ERP, without further analysis. ... ERP is a forward-looking concept. It is an expectation as of the valuation date for which no market quotes are directly observable. While an analyst can observe premiums realized over time by referring to historical data (i.e., realized return approach or ex post approach), such realized premium data do not represent the ERP expected in prior periods, nor do they represent the current ERP estimate."[166]

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[162] *Id.*

[163] *Id* at 61. The three studies are (1) 5.78% - Ibbotson historical stock-bond return study; (2) 9.34% - a regression of the monthly returns of Ibbotson historical stocks and corporate bonds; and (3) 9.55% - Ibbotson historical stock-bond returns using his PRPM.

[164] *Id.* at 62-63.

[165] Mr. D'Ascendis stated in his direct testimony that he used studies of returns published by "Ibbotson." The compilation of historical returns is now compiled and published by the investment advisory firm Duff & Phelps, formerly Morningstar and before that Ibbotson Associates. *Id* at 64-65; 80.

[166] *Id* at 64-65; *see also* CARD Exh. 4 – Woolridge Dir. at Exhibit JRW-8 for a compilation of Duff & Phelps' recommendations regarding equity risk premiums.

Moreover, as of December 9, 2020, Duff & Phelps decreased its U.S. equity risk premium from 6.00% to 5.50%.[167] Mr. D'Ascendis' analysis, while using the *historical* average annual stock return published by Duff & Phelps, he ignores Duff & Phelps' recommendation as to how to use those data to determine the appropriate ERP. "Duff & Phelps employs a multi-faceted analysis to estimate the conditional ERP that takes into account a broad range of economic information and multiple ERP estimation methodologies to arrive at its recommendation."[168] Mr. D'Ascendis' risk premium of 10.92% finds no support in the very sources upon which he relied nor in the evidentiary record.

Second, the variability in returns included in his study alone – ranging from a low of 7.62% for Ameren to a high of 13.38% for Entergy – makes suspect Mr. D'Ascendis' analyses suggesting the companies in his analyses are not similar to each other or to SWEPCO.[169] And perhaps not surprisingly, Mr. D'Ascendis' PRPM model produces very high and variable equity cost-rate estimates. For example, the average beta used by Mr. D'Ascendis for electric utility companies is 0.85, which indicates these stocks are less volatile than the overall stock market. Yet, the variation in the PRPM equity cost rates for the electric companies he looks to are 7.62% to 13.38%.[170] One would expect that similar-risk companies would display a closer range in equity costs; the wide range in variation in the cost of equity capital makes no sense for similar risk companies and thus, those data do not provide reliable estimates of equity cost rates.[171]

Further, it bears repeating: Mr. D'Ascendis' projected market returns are based on highly unrealistic assumptions about future earnings and economic growth and the resulting stock returns, leading to an upwardly biased result. On this point, he makes the assumption that the companies in the S&P 500 can grow their earnings, on average, at 12.45%, which is nearly triple the long-term projected growth rate of the economy as measured by GDP.[172]

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[167] *Id* at 65.

[168] *Id.* at 64.

[169] *Id.* at 63.

[170] *Id*

[171] *Id* at 62-63.

[172] *Id* at 58.

Dr. Woolridge performed a study of the growth in nominal GDP, S&P 500 stock-price appreciation, and S&P 500 EPS and DPS growth since 1960. A summary of his results is shown in Table 8, below:

Table 8

GDP, S&P 500 Stock Price, EPS, and DPS Growth

1960-Present[173]

Nominal GDP	**6.28**
S&P 500 Stock Price	**7.20**
S&P 500 EPS	**6.53**
S&P 500 DPS	**5.75**
Average	**6.44**

The results show that the historical long-run growth rates for GDP, S&P EPS, and S&P DPS are in the 6% to 7% range, compared to the average EPS growth rate of 12.45% used by Mr. D'Ascendis. Mr. D'Ascendis' estimated growth rates for EPS of 11.46%, 11.55%, and 14.33%, suggest that companies in the U.S. would be expected to increase their growth rate of EPS in the future by almost 100% and maintain that growth indefinitely in an economy that is expected to grow at about one-third of Mr. D'Ascendis' projected growth rates.

Further, the unrefuted evidence is that there is a direct link between long-term EPS and GDP growth.[174] The components of nominal GDP growth are real GDP growth and inflation. The annual *real* GDP growth rate from 1961 to 2020, has gradually declined from the 5.0% to 6.0% range in the 1960s to the 2.0% to 3.0% range during the most recent five-year period, with the exception of the year 2020 (-3.5%).[175] Nominal GDP growth for that same period, measured by the Consumer Price Index ("CPI"), shows marked increases in prices from the late 1960s to the early 1980s followed by a rapid decline during the 1980s as inflation declined from above 10% to about 4%, and gradually declining to the 2.0% range or below over the past five years.[176]

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[173] *Id.* at 70; Exhibit JRW-10 at 1.

[174] *Id.* at 71; Exhibit JRW-10.

[175] *Id*

[176] *Id* at 71-72.

To gauge the magnitude of the decline in nominal GDP growth, Dr. Woolridge compiled the compounded GDP growth rates for 10, 20, 30, 40, and 50 years as shown in Table 9, below:

Table 9

Historical Nominal GDP Growth Rates[177]

10-Year Average	**3.40%**
20-Year Average	**3.63%**
30-Year Average	**4.27%**
40-Year Average	**5.10%**
50-Year Average	**6.12%**

The 50-year compounded GDP growth rate is 6.12%. However, as Dr. Woolridge noted, there has been an undoubtable and significant decline in nominal GDP growth over subsequent 10-year intervals strongly suggesting that nominal GDP growth in recent decades has slowed, and that the more realistic GDP growth rate is in the range of 4.0% to 5.0%.[178]

Additionally, long-term GDP projections also indicate slower GDP growth in the future.[179] The mean 10-year nominal, GDP-growth forecast (as of March 2020) by economists in the recent *Survey of Financial Forecasters* is 4.30 percent.[180] The federal Energy Information Administration (EIA), in its projections used in preparing *Annual Energy Outlook,* forecasts long-term GDP growth of 4.2 percent for the period 2019–2050.[181] The Congressional Budget Office (CBO), in its forecasts for the period 2019 to 2029, projects a nominal GDP growth rate of 3.8 percent.[182] Finally, the Social Security Administration (SSA), in its Annual OASDI Report, provides a projection of nominal GDP from 2020–2095.[183] SSA's projected growth GDP growth

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[177] *Id* at 72.

[178] *Id* at 71-73.

[179] *Id*

[180] *Id*

[181] *Id.*

[182] *Id.*

[183] *Id.* at 72-73.

rate over this period is 4.1 percent. Overall, these forecasts suggest long-term GDP growth rate in the 4.0–4.3 percent range.

Also, global economic growth is projected to slow significantly in the years to come. A study by the consulting firm McKinsey & Co. estimates that employment growth will slow to 0.3% over the next fifty years and concludes that even if productivity remains at the rapid rate of the past fifty years of 1.8%, real GDP growth will fall by 40 percent to 2.1%.[184]

Moreover, over the medium to long run, S&P 500 EPS growth does not outpace GDP growth. While some search to minimize the link between growth in GDP and EPS, these differences are short term, but the long-term link is irrefutable.[185]

Lastly, Dr. Woolridge's analysis establishes the folly of Mr. D'Ascendis' EPS growth rate of 12.45%. Dr. Woolridge first reviewed the 2019 aggregate net income for the S&P 500 companies and 2019 nominal GDP for the U.S.[186] The aggregate profit for the S&P 500 companies represented 6.53% of nominal GDP in 2019.[187] Dr. Woolridge next projected the aggregate net income level for the S&P 500 companies and GDP as of the year 2050. For the growth rate for the S&P 500 companies, he used Mr. D'Ascendis' average projected S&P 500 EPS growth rate of 12.45%. For nominal GDP, he used the average of the long-term projected GDP growth rates from SFF, CBO, SSA, and EIA (4.3%, 3.8%, 4.1%, and 4.0%, respectively), which is 4.09%.[188] Dr. Woolridge's analysis projected the aggregate net income level for the S&P 500 companies to be $19.1 trillion in 2050.[189] Over the same period GDP is expected to grow to $74.3 trillion. Based on Mr. D'Ascendis' projected growth rate in EPS, and if nominal GDP grows at rates projected by major government agencies, the net income of the S&P 500 companies will represent growth from 6.53% of GDP in 2019 to 71.62% of GDP in 2050, an entirely unrealistic share of GDP.[190]

Notwithstanding the link between growth in GDP and EPS, Mr. D'Ascendis' analysis suggests that the growth in EPS will exceed the growth by almost thrice fold, and that it will do so

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[184] *Id* at 73.

[185] *Id* at 74-75.

[186] *Id* at 76.

[187] *Id.*

[188] *Id.*

[189] *Id.*

[190] *Id.* at 76-77.

indefinitely.[191] The data, and certainly the evidentiary record, do not support Mr. D'Ascendis' average projected EPS growth rate of 12.45%.[192]

d. CAPM Approach

The CAPM approach requires an estimate of the risk-free interest rate, the beta, and the market- or equity-risk premium. Mr. D'Ascendis' CAPM analysis suffers from two fundamental flaws: (1) he has used a non-traditional CAPM approach, the empirical CAPM (ECAPM), as an equity cost-rate approach; and (2) most significantly, he relied on his market-risk premium of 10.92% using the same six approaches used in his Risk-Premium approach. As discussed earlier in CARD's Initial Brief, the 10.92% market-risk premium is markedly higher than published market-risk premiums that he developed using highly unrealistic assumptions of future earnings growth and stock-market returns.[193]

Mr. D'Ascendis' ECAPM analysis is a variation of the CAPM approach to estimate the cost of equity capital.[194] But the ECAPM is nothing more than an *ad hoc* version of the CAPM and has not been theoretically or empirically validated in refereed journals.[195] The ECAPM provides for weights which are used to adjust the risk-free rate and market-risk premium in applying the ECAPM. Mr. D'Ascendis uses 0.25 and 0.75 factors to boost the equity risk premium measure, but provides no empirical justification for those figures.[196] Mr. D'Ascendis takes his analysis a step further and uses adjusted betas to produce his ECAMP results, a practice at best untested.[197]

In short, Mr. D'Ascendis' ECAPM produces unreliable outputs.

e. Use of Non-Price Regulated Companies

Mr. D'Ascendis also estimates the cost of equity capital using the same flawed equity-cost rate approaches he employed for his DCF and CAPM analyses and applying it to a group of what contends are non-price regulated companies with "comparable risk" to SWEPCO. However,

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[191] HOM TR. Vol. 4 at 943:4-24.

[192] CARD Exh. 4 – Woolridge Dir. at 73; 78.

[193] *Id.*

[194] *Id.* at 79.

[195] *Id.*

[196] *Id.*

[197] *Id.*

beyond suffering from the same upward bias Mr. D'Ascendis' analysis presents, the companies in his group of non-price regulated companies are not truly comparable to SWEPCO.[198] As Dr. Woolridge testified:

> This approach is fundamentally flawed for two reasons. First, while many of these companies are large and successful, their lines of business are vastly different from the regulated electric utility business and they do not operate in a highly regulated environment. Second, the previously discussed upward bias in the EPS growth-rate forecasts of Wall Street analysts is particularly severe for non-utility companies and, therefore, the DCF equity cost rate estimates for this group are particularly overstated.[199]

On cross-examination Mr. D'Ascendis attempted to defend his use of non-price regulated companies equating, e.g., Northrop Grumman, a defense contractor, or Altria, a cigarette company, or Estee Lauder, a make-up company, or Sirius XM Holdings, a satellite radio company, to the provision of a regulated utility service.[200] While the defense of our Nation is crucial, and, at least according to conventional wisdom, quitting smoking is more than a mere challenge, neither is comparable to the provision of reliable electric utility service. And while it may be difficult to find someone who does not enjoy a good Kiss every now and then – of the chocolate variety from Hershey – not having one is not equivalent to or a "proxy" for not having electric utility service.

CARD urges the ALJs to give no countenance to Mr. D'Ascendis' comparison of SWEPCO to his list of non-price regulated companies and recognize it for what it is: Nothing more than an effort to further inflate his recommendation regarding SWEPCO's ROE.

f. Adjustments for SWEPCO's Size and Credit-Ratings

Mr. D'Ascendis concludes that his equity cost-rate studies suggest a ROE range of 9.85% to 10.96%.[201] But to arrive at his recommended of 10.35%, he adds 47 basis points to his equity cost-rate range, adding 20 basis points to account for SWEPCO's size and 27 basis points to account for SWEPCO's credit ratings. The more credible evidence is that of Dr. Woolridge: A

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[198] *Id* at 58.

[199] *Id.* at 79.

[200] HOM TR. Vol. 4 at 931:18 – 933:12.

[201] CARD Exh. 4 – Woolridge Dir. at 59.

small-size premium is not appropriate for regulated public utilities and the credit ratings do not justify an equity cost-rate-risk adjustment.[202]

Further, on cross-examination it became apparent that the companies whose ROEs were adjusted upwards to compensate for the perceived risk of being a smaller company, are truly small in size.[203]

Lastly, the Mr. D'Ascendis could point to no Commission precedent in which the Commission approved an adjustment to an electric utility's ROE based on its size.

With regard to Mr. D'Ascendis' credit-risk adjustment of 27 basis points, too, finds no precedence in the Commission's decisions regarding ROEs for electric utilities.[204] Further, Mr. D'Ascendis' risk assessment is fatally flawed. First, he computes the credit ratings for the operating subsidiaries of the *proxy* companies, and not the *parent* holding companies. It is the parent holding companies that are represented in the proxy groups and not the operating subsidiary utility companies.[205] The operating companies, like SWEPCO, do not have common stock outstanding and so they cannot be used to estimate an equity cost rate. Therefore, the correct comparison is between SWEPCO and the proxy holding companies, not the subsidiaries.

Second, he only compares the Moody's ratings, and ignores the S&P ratings and thus fails to account for SWEPCO's higher S&P rating (A- vs. BBB+), which suggests that SWEPCO is less risky than the proxy group. SWEPCO's S&P rating is one notch above the average of the proxy group and SWEPCO's Moody's rating is one notch below the average of the two proxy groups. As Dr. Woolridge noted, "this comparison suggests that SWEPCO's investment risk level is similar to the average of the proxy group and therefore no credit-risk adjustment is necessary."[206]

Mr. D'Ascendis's recommendations are based on inflated, upwardly biased expected market returns and unrealistic growth in earnings per share that ignore capital market conditions. Thus, CARD urges the ALJs to reject Mr. D'Ascendis' recommendations regarding SWEPCO's

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[202] *Id* at 80-83.

[203] HOM TR. Vol. 4 at 927:24 – 929:5; CARD Exh. 29.

[204] HOM Tr. Vol. 4 at 911:10-20; 926:5-9.

[205] CARD Exh. 4 – Woolridge Dir. at 84.

[206] *Id* at 85.

cost of equity and urges the ALJs to adopt Dr. Woolridge's recommendation regarding SWEPCO's cost of equity and capital structure.

1. Cost of Debt

CARD did not dispute SWEPCO's cost of long-term debt, which SWEPCO presented as being 4.18%.

A. Capital Structure [PO Issue 7]

CARD accepted SWEPCO's capital structure shown in the table below:

Capital Source	Capitalization Ratios	Cost
Long-Term Debt	**50.63%**	**4.18%**
Common Equity	**49.37%**	
Total Capitalization	**100.00%**	

B. Financial Integrity, Including "Ring Fencing" [PO Issue 9]

CARD reserves the right to reply to other parties' briefs regarding issues related to "Ring Fencing."

IV. Expenses [PO Issues 1, 14, 24, 29, 30, 32, 33, 40, 41, 42, 44, 45, 46, 49, 72, 73, 74]

A. Transmission and Distribution O&M Expenses [PO Issue 14, 24]

1. Transmission O&M Expense [PO Issue 24]

2. Transmission expense and revenues under FERC-approved tariff [PO Issue 46]

3. Proposed Deferral of SPP Wholesale Transmission Costs [PO Issues 72, 73, 74]

4. Distribution O&M Expense [PO Issue 24]

5. Distribution Veg Mgmt Expense & Program Expansion [PO Issue 27]

CARD urges the ALJs and Commission to reject SWEPCO's request to increase its vegetation management expense by $5 million above the test-year expense of $9.57 million for a total Texas Retail jurisdictional expense level of $14.57 million.[207]

SWEPCO's request is unneeded and unwarranted. In SWEPCO's 2016 rate case – Docket No. 46449 – SWEPCO received a $2 million increase over its Test Year amount of vegetation management costs for a total authorized expense level of $9.93 million.[208] However, SWEPCO's system reliability measures did not meaningfully increase even though the amount the Commission approved for vegetation management increased. SWEPCO reported a SAIFI of 1.73 for 2016 and 1.79 for the Test Year in this case, which is virtually no difference at all.[209]

In addition, SWEPCO's spending level for vegetation management during the Test Year – $9.57 million – is almost identical to the $9.93 million the Commission approved in Docket No. 46449. This is true despite the fact that SWEPCO was free to spend more than this amount if it needed; indeed, a public utility is required to spend more than the level approved to provide safe

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[207] CARD Exh. 2 – M. Garrett Dir. at 37.

[208] Docket No. 46449, Order on Rehearing at FOF 206.

[209] CARD Exh. 2 – M. Garrett Dir. at 38.

and reliable service to customers.[210] Thus, there is no need to increase SWEPCO's vegetation management spending level by any amount, much less the $5 million SWEPCO requests.

6. Allocated Transmission Expenses related to retail behind-the-meter generation

CARD reserves the right to reply to other parties' briefs regarding issues related to behind-the-meter generation.

B. Generation O&M Expense

1. Dolet Hills Non-Fuel O&M

SWEPCO has announced that it plans to retire Dolet Hills no later than December of 2021, which is approximately two months after the Commission is expected to issue its final order regarding the Company's new base rates. [211] However, SWEPCO's proposed rate increase does not adjust the Test Year O&M expense for Dolet Hills to reflect the scheduled retirement of the plant in December 2021.[212] By ignoring the retirement of Dolet Hills, SWEPCO's requested revenue requirement is inflated since there will be no significant O&M costs after the plant has been retired, and critically, will reward SWEPCO with revenue for expenses it will not incur.

SWEPCO incurred approximately $12.5 million for the Company's 257 MW (40.28%) ownership share of Dolet Hills non-fuel O&M expense during the Test Year, and is requesting that the entire $12.5 million amount be included in its new base rates,[213] even though SWEPCO will not incur significant non-fuel O&M expenses at Dolet Hills after it retires the plant. In fact, even during the Test Year, SWEPCO operated Dolet Hills almost entirely only during the summer months, thus the O&M expenditures for the plant are likely to be greatly reduced by the time the Commission approves the Company's new base rates.

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[210] *Id.* at 39.

[211] SWEPCO Exh. 11 – Direct Testimony of Monte A. McMahon at 11 (hereinafter, "SWEPCO Exh. 11 – McMahon Dir. at __.").

[212] CARD Exh. 20.

[213] See CARD Exh. 3 –Norwood Dir. at Attachment SN-4, SWEPCO's responses to CARD 1-15 and Schedule H-1.2.

a. Dolet Hills Net Capacity Factor Has Continued to Decline

A generating unit's net capacity factor is the ratio of the net electricity generated, for the time considered, to the energy that could have been generated at continuous full-power operation during the same period of time. From 2017 through 2019 (2020 data has not yet been made available), the net capacity factor for the Dolet Hills Unit has declined year over year.[214] In 2017, Dolet Hill's average net capacity factor was 35.4% and CLECO (the operating company for Dolet Hills[215]) operated Dolet Hills only eight months in 2017 – and in only five months in 2017, did Dolet Hills' net capacity factor rise above 50%.[216]

Then in 2018, Dolet Hills' average net capacity factor fell to 26.4%, with CLECO operating Dolet Hills only 8 months out of the year, and only two of those eight months saw Dolet Hills' net capacity factor rise above 50%.[217] Subsequently, in 2019, Dolet Hills' average net capacity factor fell again to 20.6%, with CLECO operating Dolet Hills only seven months out of the year, and only three of those seven months saw Dolet Hills' net capacity factor rise above 50%.[218]

Because non-fuel O&M expenses for lignite-fired generating units vary with the volume of lignite that is burned for energy production, the significant decline in Dolet Hills generation under the recently implemented restricted "summer only" operating plan (as indicated by declining capacity factor) further justifies a reduction in the O&M expenses for the plant included in SWEPCO's new base rates, even if the plant was not scheduled to be retired this year.

Therefore, CARD urges the ALJs to reduce the O&M expense for Dolet Hills reflected in the Company's new base rates by adjusting the amount to reflect a Total Company expense level of approximately $2.1 million.

2. Retired Gas-Fired Generating Units Non-Fuel O&M Expense

SWEPCO's non-fuel O&M request does not reasonably account for the fact that the Company retired 5 gas-fired generating units during and immediately preceding and following the Test Year. Specifically, in January 2019 SWEPCO retired Knox Lee Unit 4, and subsequently in

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[214] CARD Exh. 9 at 2, 9, and 15.

[215] HOM TR. Vol. 1 at 132.

[216] CARD Exh. 9 at 2.

[217] *Id.* at 9.

[218] *Id* at 15.

May 2020, SWEPCO retired Knox Lee Units 2 and 3, Lieberman Unit 2, and Lone Star Unit 1.[219] The Table 1 from Mr. Norwood's direct testimony, below, shows the retirement dates for these units.

Table 1
SWEPCO Retired Gas-Fired Units

Plant/Unit	MW	Retirement Date
Knox Lee Unit 2	**30**	**5/1/20**
Knox Lee Unit 3	**31**	**5/1/20**
Knox Lee Unit 4	**30**	**1/1/19**
Lieberman Unit 2	**26**	**5/1/20**
Lone Star Unit 1	**50**	**5/1/20**
Total Retired	**167**	

The retirement of these 5 gas-fired units are known and measurable changes that will reduce O&M expenses from the amount of O&M expenses SWEPCO incurred during the Test Year. As a result of SWEPCO's failure to adjust its Test Year O&M expenses to reflect the retirement of these gas unit, the Company's requested revenue requirement is inflated and includes expenses beyond reasonable and necessary expenses as required by PURA.

Therefore, CARD urges the ALJs to reduce the non-fuel O&M expense SWEPCO is requesting for the Lieberman, Knox Lee, and Lone Star generating stations to reflect a Total Company expense level of approximately $9.58 million.[220] Specifically, CARD urges the ALJs to adjust the Test Year expense for each plant to reflect the level of generating capacity retirements made at each plant, which reduces SWEPCO's requested Test Year O&M expense for the Lieberman, Knox Lee, and Lone Star generating stations by approximately $1.1 million.[221] This $1.1 million reduction to O&M expense is in addition to the $616,000 reduction to O&M expense that SWEPCO made in its filing in recognition of the inherent decreased non-fuel O&M costs that

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[219] SWEPCO Exh. 11 – McMahon Dir. at 9.

[220] CARD Exh. 3 – Norwood Dir. at 7.

[221] *Id.* at Attachment SN-6.

accompany the retirement of the Knox Lee Units 2, 3, and 4; the Lieberman Unit 2, and the Lone Star Unit 1.

C. Labor Related Expenses

1. Payroll Expenses

SWEPCO requests an increase of $2,143,713 in payroll expense, which includes an increase of 3.5%to reflect raises in pay occurring after the end of Test Year.[222] To calculate its adjustment, SWEPCO updated its payroll costs using the actual number of employees on the payroll in the last pay period of March 2020, which was the end of the test year, and increased that amount for prospective raises by 3.5%.[223]

CARD urges the ALJs to reject SWEPCO's requested 3.5% payroll increase. As CARD witness Mark Garrett testified, setting rates based upon a nominal pay increase such as this is almost never appropriate because the actual payroll levels will never increase by the amount of the nominal increase.[224] The actual increase does not constitute a known and measurable change to the Test Year amounts because there are too many other factors which impact the Company's overall payroll expense. These factors include:

1. Normal employee turnover that occurs when employees come onto and leave the payroll registers on a regular basis, with retiring employees taking higher salary levels off the system and new employees coming on at lower pay scale levels;
2. Workforce reorganizations where significant reductions in the workforce are achieved through new technologies or other innovations;
3. Productivity gains where reductions in workforce levels are achieved on an ongoing basis through increased employee efficiencies; and
4. Capitalization ratio changes where more payroll costs are capitalized rather than expensed during a period of capital expansion such as SWEPCO is experiencing now.[225]

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[222] SWEPCO Exh. 6 – Direct Testimony of Michael A. Baird at 21 (hereinafter, "SWEPCO Exh. 6 – Baird Dir. at __.").

[223] *Id*

[224] CARD Exh. 2 – M. Garrett Dir. at 31.

[225] *Id*

Each of the above four factors impact the overall payroll expense as much or more than pay raises and should be accounted for in determining the appropriate payroll expense for SWEPCO.

When rates are based on an historical Test Year, payroll expense should be annualized such as SWEPCO has done, but only so long as the period that is annualized is representative of ongoing expense levels.[226] It is inconsistent and inappropriate to adhere to Test Year costs such as rate base investment, depreciation expense, taxes, and revenues, but to reach beyond the Test Year for the payroll expense adjustment.[227] It is especially inappropriate to account for payroll expense in the piecemeal fashion that SWEPCO proposes, which does not account for the other factors listed above.

The 3.5% payroll increase is not a known-and-measurable change to SWEPCO's Test Year costs. However, rather than disallowing the entire increase, CARD urges the ALJs to increase SWEPCO's payroll expense by 0.87% from the Test Year level.[228] The data SWEPCO provided show that SWEPCO's payroll costs declined during the Test Year, which SWEPCO then offset with post-Test Year pay increases.[229] CARD's adjustment reflects the annualized base pay for the post-Test Year pay periods from October through December 2020.[230] CARD's adjustment accounts for SWEPCO's actual payroll costs as they existed as of December 2020, compared to SWEPCO's blanket 3.5% payroll increase, which is not a known-and-measurable change to SWEPCO's Test Year costs. The amount of this adjustment is $1,496,365 on a Total Company basis, and $585,976 on a Texas Retail basis.

For similar reasons CARD urges the ALJs to reduce the amount of AEPSC's payroll expenses allocated to SWEPCO. Like SWEPCO, AEPSC also experienced a reduction in the number of employees following the end of the Test Year, but rather than adjust costs downward to account for the savings generated by having fewer employees on the payroll, SWEPCO increased the allocated payroll costs from AEPSC by $3.8 million, or, 9.8% above Test Year

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[226] *Id* at 32.

[227] *Id.* at 35.

[228] *Id.* at 33.

[229] *Id* at 32.

[230] *Id.* at 33.

levels.[231] AEPSC's post-Test Year payroll costs were only 0.24% greater than SWEPCO's.[232] CARD thus urges the ALJs to set AEPSC's payroll expense at the Test-Year level to reflect the reduction in employee levels that offset almost all of the increases that may have occurred during the post-Test Year period. The amount of this adjustment reverses SWEPCO's proposed increase of $3,804,876 on a Total Company basis, which is $1,489,989 for the Texas Retail jurisdiction.[233]

2. Incentive Compensation

a. Short-Term Incentive Compensation

SWEPCO's incentive compensation plans are governed by an earnings per share ("EPS") funding mechanism that determines if and to what extent the plans are funded each year.[234] During the Test Year, 100% of SWEPCO's funding mechanism was tied to financial measures, and so, in accord with Commission precedent,[235] CARD urges the Commission to remove 50% of the 100% that was tied to financial measures. The amount of this adjustment is $2,187,400 on a Total Company Basis, which equates to $856,586 on a Texas Retail basis.[236] Additionally, CARD urges the Commission to reduce SWEPCO's related payroll taxes should be reduced by $55,381 on a Texas Retail basis.[237]

CARD's adjustment follows the precedent the Commission established in Docket No. 46936. In Docket No. 46936, the Commission not only disallowed 100% of short-term incentives directly related to financial measures, consistent with its long-standing policy on this issue, but also disallowed 50% of the remaining incentives because they were indirectly tied to financial performance through an earnings-per-share funding mechanism.[238] The Commission affirmed this treatment in SWEPCO's previous rate case – Docket No. 46449 – in which the Commission

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[231] *Id.* at 34.

[232] *Id*

[233] *Id*

[234] *Id* at 15.

[235] *Application of Southwestern Public Service Company for Authority to Change Rates*, Docket No. 43695, Order on Rehearing at pp. 5-6; *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 46449, Order on Rehearing at FOFs 106-198 (Mar. 19, 2018); Docket No. 46449, Proposal for Decision at 241-243 (Sept. 22, 2017).

[236] CARD Exh. 2 – M. Garrett Dir. at 18.

[237] *Id.*

[238] *Id* ; Docket No. 43695, Order on Rehearing at pp. 5-6.

removed 37.5% of SWEPCO's short-term incentives, which equates to 50% of the 75% of the funding mechanism that was tied to financial measures during the test-year in that case.[239]

In this case, however, SWEPCO increased the funding mechanism tied to financial measures from 70% to 100% during the Test Year.[240] SWEPCO asserted that the need for the increase to 100% was due to the financial volatility and rapidly changing business conditions in the wake of the COVID-19 pandemic.[241] As a result of the switch to the 100% funding mechanism, SWEPCO jettisoned the other 40% (30% as adjusted) of the funding mechanism triggers, which were composed of non-EPS factors including safety, compliance, and strategic initiatives.[242] Further, not only did SWEPCO decide to focus exclusively on the EPS funding trigger by increasing it to 100% of the funding mechanism, it also increased the EPS target in the funding mechanism from $3.95 per share in 2019 to $4.25 per share in 2020.[243]

In an apparent nod to the Commission's decisions in Docket Nos. 43695 and 46449, SWEPCO removed 50% of the 70% of the funding mechanism tied to financial measures. In Mr. Baird's direct testimony, Mr. Baird claimed that the Company based its adjustment of the 70% of the funding mechanism tied to financial measures because it anticipated reverting back to a 70% financially-based funding trigger at some unspecified point in the future.[244] However, in rebuttal testimony, SWEPCO changed its rationale by claiming that the reason for using 70% was because that was the actual percentage it used in its funding mechanism for the first three quarters of the Test Year and the 100% figure was used for only the last quarter of the Test Year.[245] Regardless of SWEPCO's conflicting accounts regarding its rationale for using the 70% figure, the fact remains that 100%, not 70%, was the percentage that was in place at the end of the Test Year on March 31, 2020.[246]

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239 Docket No. 46449, Order on Rehearing at FOFs 106-198; Docket No. 46449, Proposal for Decision at 241-243.

240 CARD Exh. 2 – M. Garrett Dir. at 18; HOM TR. Vol. 2 at 574:2-9.

241 SWEPCO Exh. 21 – Direct Testimony of Andrew R. Carlin at 31 (hereinafter, "SWEPCO Exh. 21 – Carlin Dir. at __.").

242 HOM TR. Vol. 2 at 574:13-22; CARD Exh. 2 – M. Garrett Dir. at Exhibit MG-4, Bates Page 00103.

243 HOM TR. Vol. 2 at 585:3-5.

244 SWEPCO Exh. 6 – Baird Dir. at 21-22.

245 SWEPCO Exh. 46 – Rebuttal Testimony of Andrew R. Carlin at 7 (hereinafter, "SWEPCO Exh. 46 – Carlin Rebuttal at __.").

246 SWEPCO Exh. 46 – Carlin Rebuttal at 7; HOM TR. Vol. 2 at 588:8-12 and 589:11-14.

Similar to SWEPCO's request to base the 3.5% payroll expense on the payroll expense at the end of the Test Year, as addressed in Sec. IV.C.1 of this brief, the percentage of the EPS-based funding trigger should be the percentage that existed at the end of the Test Year. SWEPCO must not be able to cherry-pick between whether the relevant time period for one type of cost is the end of the Test Year, or some period of time prior to the end of the Test Year, for a different type of cost. Because SWEPCO's incentive compensation funding mechanism had a 100% EPS funding trigger at the end of the Test Year, that should be the amount from which the 50% of incentives tied to the financially-based portion of the funding mechanism should be removed from SWEPCO's cost of service as established by the Commission in Docket No. 43695 and then affirmed in Docket No. 46449.

While it appears SWEPCO attempted to comply with the Commission's precedent disallowing all incentives directly tied to financial measure and 50% of the amount tied to the percentage of finically-based from its cost of service, albeit erroneously basing that adjustment on the 70% of the funding mechanism tied to financial goals, SWEPCO professes that it altogether disagrees with the Commission's precedent regarding the disallowance of financially-based incentive compensation.[247] However, CARD witness Mark Garrett explained, incentive compensation measures that are tied to financial measures should be excluded for the following reasons:

a. Payment amounts are uncertain from year to year and are only based on a tentative expense that may not be paid at all;

b. Many of the factors that significantly impact earnings are outside the control of most company employees and have limited value to customers;

c. Earnings-based plans can discourage conservation and thus be contrary to energy efficiency goals;

d. The utility and its shareholders assume none of the financial risks associated with incentive programs while ratepayers pay for the programs even if the Company does not reach its targets;

e. Incentive payments based on financial performance measures should be made from increased earnings that signify earnings objectives have been met; and

[247] SWEPCO Exh. 21 – Carlin Dir. at 39.

f. Incentive payments embedded in rates shelter the utility against the risk of earnings erosion through attrition by supplementing its earnings in years that it does not perform well.[248]

The Commission's precedent on the issue is consistent with virtually all western states, Mr. Garrett conducted a survey of 24 western states in 2007 and updated the study in 2009, 2011, 2015 and 2018. Mr. Garrett's study shows that a clear majority of the states follow the financial-performance rule, in which incentive payments associated with financial performance are excluded from rates.[249] None of the jurisdictions that Mr. Garrett studied allow full recovery of incentive compensation as a general rule.

CARD further urges the ALJs to disallow incentive compensation costs that are tied to financial measures in utility rates because:

a. Even though regulators generally disallow incentive compensation costs tied to financial measures in rates, utilities nevertheless continue to include financial performance as a key component of their plans;[250]

b. SWEPCO will not be financially-harmed if financially-based incentive compensation is excluded because they are discretionary payments limited by the Company's financial performance funding mechanism;[251] and

c. SWEPCO will not be put at a competitive disadvantage if the incentives are removed from rates because the other utilities that SWEPCO competes with for qualified personnel are also likely to have financially-based incentives removed from their rates as well.[252]

CARD urges the ALJs to maintain the Commission's long-standing approach regarding incentive compensation and to deny that portion of SWEPCO's annual incentive compensation payments that is tied to financial measures as most recently articulated in Docket No. 43695 and Docket No. 46449 regarding financially-based components of a utility's incentive compensation funding mechanism. Specifically, CARD urges the Commission to remove SWEPCO's short term incentive costs associated with 50% of the 100% financially-based funding trigger that was in place at the end of the Test Year.

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248 CARD Exh. 2 – M. Garrett Dir. at 19-21.

249 *Id* at 13.

250 *Id* at 23.

251 *Id.*

252 *Id.* at 23-24.

b. Long-Term Incentive Compensation

SWEPCO seeks to recover $1,025,993 on a Total Company basis, or $371,024 on a Texas Retail basis, in expenses for its long-term-incentive plan.[253] SWEPCO has excluded from this amount costs based on performance unit awards because these awards are tied to financially-based performance targets.[254] SWEPCO seeks to recover the portion that is tied to restricted stock units ("RSUs") because it asserts that RSU are not based on any performance measures.[255] CARD urges the ALJs to exclude the entire amount for long-term-incentive compensation from SWEPCO's cost of service.

Contrary to SWEPCO's claim, RSUs are without question tied to SWEPCO's financial performance. As CARD witness Mr. Mark Garrett testified, the value of the RSUs is directly tied to the value of the Company's stock.[256] The RSUs granted to employees vest over three vesting dates after the grant date and dividend payments are awarded as additional RSUs when a dividend is paid on AEP common stock.[257] Therefore, like the performance units, RSUs are tied to financial measures since the value of the compensation an employee receives is tied to the increase in value of AEP's stock over the course of the vesting period.[258] Consequently, both the performance units and RSUs are designed to align the interests of AEP's management with the interests of shareholders.[259]

SWEPCO's internal documentation confirms that performance units and RSUs are financially based and designed to benefit shareholders rather than customers. AEP's 2020 Proxy Statement describes the purpose of the RSUs as follows:

> The HR Committee believes that these retention awards are in the best interests of the Company and its shareholders and will further align the interests of these executives with those of shareholders.[260]

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253 *Id* at 24.

254 SWEPCO Exh. 21 – Carlin Dir. at 42.

255 *Id* at 42.

256 CARD Exh. 2 – M. Garrett Dir. at 25.

257 *Id*

258 *Id*

259 CARD Exh. 1 – Direct Testimony and Exhibits of David J. Garrett at 25 (hereinafter, "CARD Exh. 1 – D. Garrett Dir. at __.").

260 CARD Exh. 27 at 3.

During the hearing on the merits, SWEPCO witness Andrew Carlin agreed that AEP's shareholders have an interest in increasing or at least maintaining the Company's share value.[261] Logic dictates that if the interests of executives receiving RSUs and the shareholders are being further aligned through the award of RSUs to executives, as AEP's Proxy Statement states, and that AEP's shareholders have an interest in maintaining or increasing the Company's share value, then the RSUs are meant to incentivize executives to increase the Company's share value. There is no doubt that the RSUs are a financially-based form of incentive compensation.

Further, SWEPCO's top-level employees have a fiduciary duty to the corporation itself and not to the customers. Consequently, shareholders not ratepayers should be responsible for funding executive bonuses, incentive compensation, and supplemental benefits.[262]

Moreover, even though SWEPCO claims these expenses should be recovered in rates because they are necessary to attract and retain key personnel, the facts in the record contradict SWEPCO's claim. As explained previously with respect to annul incentive compensation, SWEPCO is not placed at a competitive disadvantage in attracting talented employees because most states exclude executive incentive compensation.[263] Utilities in other states that SWEPCO competes with for personnel are also not recovering those expenses tied to incentive compensation in rates. Therefore, it is unnecessary for SWEPCO to recover these expenses in rates and, if SWEPCO believes they are necessary, nothing prevents SWEPCO from having shareholders pay for these programs.

In SWEPCO's last rate case, Docket No. 46449, the Commission prohibited SWEPCO from recovering the cost of performance units through rates but allowed recovery of costs related to RSUs. The Commission's Order on Rehearing states that "SWEPCO removed the entirety of its financially based long-term incentive compensation in the amount of $2,140,880. However, the $359,705 of restricted stock units are not based on financial measures as are other SWEPCO or AEP incentive plans and are appropriate to include in SWEPCO's rates."[264] CARD respectfully requests that the Commission reconsider its decision in Docket No. 46449 and disallow the costs

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[261] HOM TR. Vol. 2 at 593:11-15.

[262] CARD Exh. 2 – M. Garrett Dir. at 25.

[263] *Id.* at 24 and 29.

[264] Docket No. 46449, Order on Rehearing at FOF 199.

associated with both performance units and RSUs from rate recovery. Both performance units and RSUs are financially-based compensation and there is no good reason to treat them differently. Both types of units are denominated in AEP stock units and the values of both correspond to the market price of AEP stock. Plus, AEP's own internal documents show that both performance units and RSUs have the effect of aligning participants' financial interests with those of AEP's shareholders.

3. Severance Costs

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

4. Other Post-Retirement Benefits [PO Issue 41]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

D. Depreciation and Amortization Expense [PO Issue 29]

CARD urges the ALJs to approve several changes to SWEPCO's depreciation rates, which are supported by a depreciation study SWEPCO witness Mr. Jason A. Cash performed. Mr. Cash's study is in many instances based on unreliable data, erroneous assumptions, and flawed analysis. CARD's depreciation expert Mr. David J. Garrett reviewed Mr. Cash's study, identified the problems in Mr. Cash's study, and has in turn corrected the errors in Mr. Cash's analysis.

A summary of the effect of CARD's recommendations is illustrated in the figure below, which shows SWEPCO's proposed depreciation accrual amounts as compared to CARD's recommended depreciation accruals by function:

Figure 1: CARD Summary Depreciation Adjustment[265]

Plant Function	Plant Balance 12/31/2019	SWEPCO Proposed Accrual	CARD Proposed Accrual	**CARD Adjustment**
Production	$ 4,276,623,503	$ 115,877,699	$ 110,908,141	$ (4,969,558)
Transmission	2,056,196,799	47,890,727	43,360,540	(4,530,187)
Distribution	2,271,709,069	63,573,769	55,268,012	(8,305,757)
General	209,693,771	6,441,093	6,441,091	(2)
Total	$ 8,814,223,142	$ 233,783,288	$ 215,977,784	**$ (17,805,504)**

[265] CARD Exh. 1 – D. Garrett Dir. at 2.

As Figure 1 shows, CARD's recommendation reduce SWEPCO's proposed depreciation accrual by approximately $17.8 million on a Total Company basis. The effect of this adjustment reduces SWEPCO's revenue requirement by approximately $18.4 million on a Total Company basis which is $7.1 million on a Texas Retail basis.[266]

CARD's adjustments are based on Mr. Garrett's recommendations to: 1) reject SWEPCO's inclusion of arbitrary and unsupported contingency factors that increase decommissioning costs by 10% and reduce scrap value by 10%; 2) reject the 2.22% escalation factor SWEPCO applied to its estimated costs to demolish its current generation plant without also applying a discount rate; and 3) extending the service lives of nine of the Company's accounts which results in lower depreciation accruals for each account. The impacts of Mr. Garrett's recommended adjustments are shown in Figure 2 below:

Figure 2: Broad Issue Impacts[267]

Issue	Impact
1. Removing contingency factor from demolition cost estimates	$1.3 million
2. Remove escalation factor from demolition cost estimates	$3.7 million
2. Proposing longer service lives for nine mass property accounts	$12.8 million
Total	**$17.8 million**

SWEPCO has the burden of proof to make a "convincing showing that the amounts that it has charged to operating expenses for depreciation have not been excessive."[268] Mr. Garrett's testimony shows in numerous instances how SWEPCO has failed to meet its burden, and consequently, CARD urges the ALJs to approve Mr. Garrett's depreciation rates and reject SWEPCO's depreciation rates.

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[266] CARD Exh. 6 –Nalepa Dir. at 4 (Figure1).

[267] CARD Exh. 1 – D. Garrett Dir. at 3.

[268] CARD Exh. 1 – D. Garrett Dir. at 5 (citing to *Lindheimer v Illinois Bell Tel. Co* , 292 U.S. 151, 169 (1934)).

1. Net Salvage/Demolition Study

CARD urges the ALJs to reject SWEPCO's calculation of net salvage estimates for its production plants for two reasons. First, SWEPCO's demolition studies include arbitrary and unsupported contingency factors that increase decommissioning costs by 10 percent and reduce scrap value estimates by 10 percent. Second, SWEPCO escalated the demolition costs into the future without applying a discounted rate. Both of these problems results in the Company's terminal net salvage rates for the affected production plants to be inflated.

a. Contingency Factors

SWEPCO based its terminal net-salvage rates based on decommissioning cost estimates provided by Mr. Paul M. Eiden. Mr. Eiden applied a positive 10% contingency factor to estimated labor costs, estimated materials costs, and to the estimated indirect costs, and a negative 10% contingency factor to scrap value.[269] Mr. Eiden justifies using a 10% contingency factor because future plant configurations change over time and unknown challenges will occur during demolition that cannot be predicted.[270]

SWEPCO's inclusion of a 10% contingency factor is inappropriate because the underlying costs themselves – the costs to demolish a generation plant at some distant point in the future – are not known and measurable. In Docket No. 40443, the Commission rejected SWEPCO's request to include interim retirements (retirements of components of a plant prior to the retirement of the plant itself) in the calculation of production-plant depreciation rates precisely because the rate at which retirements will be made in the future is not something that is known and measurable.[271] Indeed, future decommissioning costs are even less known and measurable than interim retirements.[272] Applying a 10% contingency factor on top of future costs that are uncertain further exacerbates the problems with such costs.[273]

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[269] SWEPCO Exh. 15 – Direct Testimony of Paul M. Eiden at Exhibit PME-2, Page 7 of 213 (hereinafter, "SWEPCO Exh. 15 – Eiden Dir. at __.").

[270] SWEPCO Exh. 42 – Rebuttal Testimony of Paul M. Eiden at 4 (hereinafter, "SWEPCO Exh. 42 – Eiden Rebuttal at __.").

[271] Docket No. 40443, Order on Rehearing at FOF 195 (Mar. 6, 2014).

[272] CARD Exh. 1 – D. Garrett Dir. at 8.

[273] *Id*

It is fundamentally unjust to increase a cost estimate by 10% (or some other amount) because it is uncertain when the same argument could be made in support of decreasing the amount by the same percentage.[274] To be clear, SWEPCO's request is that the Commission approve, in some cases up to 50 years in advance for some of the plants, over $200 million of future costs that may never be realized.[275] Ratepayers should not be on the hook under the false premise that such costs will be unquestionably incurred.

In addition, the contingency factors are arbitrary. SWEPCO asserts that the contingency factors are based on the level of detail included in the cost estimates regarding the scope of demolition for the plants.[276] However, SWEPCO did not provide any calculations or other formal analysis to show why a 10% contingency factor is appropriate for the expected costs to demolish these particular plants. Even if the percentage may vary with the scale of the study – higher if less detailed or lower if more detailed – there is no credible evidence that 10% is the correct contingency factor for this particular study.

Moreover, the study was based on the unique characteristics of each of the generation sites.[277] This resulted in a great disparity in demolition cost estimates ranging between $2 million for the Lone Star Plant Unit 1 and $26 million for the Dolet Hills Unit 1.[278] Nevertheless, the study applied the same flat 10% contingency factor to each one of the plants.[279] The factors are arbitrary and for that reason CARD urges the Commission to reject the use of these contingency factors.

CARD is mindful of the Commission's decision in Docket No. 46449 approving the use of a 10% contingency factor for SWEPCO. However, CARD urges the ALJs to reconsider SWEPCO's use of a contingency factor and the validity of the Commission's reasoning in Docket No. 46449 given that the Commission rejected the inclusion of interim retirements in calculating depreciation rates in Docket No. 40443.

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[274] *Id.*

[275] *Id* at 7.

[276] SWEPCO Exh. 42 – Eiden Rebuttal at 5.

[277] SWEPCO Exh. 15 – Eiden Dir. at 4.

[278] *Id* at 6, Table 1.

[279] *See* SWEPCO Exh. 15 – Eiden Dir. at Exhibit PME-2.

b. Escalation Rate

SWEPCO proposes to escalate the present estimated generation plant demolition costs by 2.22%. The ALJs should reject this proposal for two reasons. First, the escalation of estimated demolition costs is unwarranted given that the underlying costs are not known and measurable. In addition, the anticipated retirement dates, upon which the demolition costs are based, may change as events unfold in the future.[280] Current ratepayers should not be charged for the uncertain underlying demolition costs themselves and certainly should not have to pay for the much higher escalated amount of those costs. The difference is highly significant.

The current estimated cost to demolish all of SWEPCO's generation plants is $179 million.[281] Applying the 2.22% escalation factor, the total cost at the time of retirement is $295 million.[282] That is an approximate additional $116 million in costs that SWEPCO is asking ratepayers to pay. In light of the uncertainty whether the underlying demolition costs will ever be realized, the ALJs should not increase the burden on ratepayers by approving SWEPCO's application of an escalation factor to those costs.

Second, CARD further urges the ALJs to reject SWEPCO's escalation factor because it deprives ratepayers of the time value of money. As CARD witness David Garrett points out, it is not proper to charge current payers for a future cost that has not been discounted to present value.[283] This basic notion is reflected in the Discounted Cash Flow Model, widely used by this and other Commissions in the calculation of a regulated utility's return on equity. This model applies a growth rate to a company's dividends many years in the future and that dividend stream is then discounted back to the current year by a discount rate in order to arrive at the present value of an asset.[284] In contrast to this commonsense approach, SWEPCO proposes to escalate the present value of its demolition costs decades into the future and is essentially asking current ratepayers to pay the future value of a cost with present day dollars. SWEPCO's approach ignores the concept of the time value of money and is inappropriate for that reason.

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[280] HOM TR. Vol. 2 at 552:21 through 553:7.

[281] *Id.* at 551:15 through 552:1.

[282] *Id.*

[283] CARD Exh. 1 – D. Garrett Dir. at 9.

[284] *Id.*; *See also* SWEPCO Exh. 8 – D'Ascendis Dir. at 25.

2. Service Lives

Account 353 – Transmission Station Equipment

CARD urges the ALJs to approve the L0.5-75 Iowa curve for this account. In contrast, SWEPCO proposes the S0-68 curve. As illustrated in Figure 3 of Mr. David Garrett's Direct Testimony, both CARD's curve and SWEPCO's curve provide relatively close visual fits to the relevant observed data, but CARD's curve will result in a longer average life and lower depreciation rate.[285] While SWEPCO's curve is not unreasonable for this account, the ALJs should recommend approval of CARD's curve because it help mitigate the otherwise substantial rate increase SWEPCO's seeks in this proceeding. It is entirely appropriate, as SWEPCO's witness Jason Cash admitted under cross-examination, for the Commission to consider ratepayers' ability to pay in establishing just and reasonable rates.[286] The COVID-19 pandemic created unprecedented economic hardship for many of SWEPCO's customers, which the Commission should take into consideration in exercising its broad discretion in setting rates.[287] Thus, CARD urges the ALJs to approve the L0.5-75 Iowa curve for this account, which results in a decrease of $1,318,069 in annual depreciation accrual.[288]

Account 354 – Transmission Towers and Fixtures

For Account 354, CARD urges the ALJs to approve the S1.5-74 curve. In comparison, SWEPCO selected the L3-65 curve. As Mr. Garrett described, both of the selected Iowa curves provide relatively close and reasonable fits to the observed data, and that all else being held equal, the S1.5-74 curve would result in a lower depreciation rate and expense.[289]

In addition, the curve CARD's urges the ALJs to approve provides a better mathematical fit than does SWEPCO's curve. Mathematical curve-fitting essentially involves measuring the distance between the OLT curve and the selected Iowa curve.[290] The best mathematically-fitted curve is the one that minimizes the distance between the OLT curve and the Iowa curve. The

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[285] CARD Exh. 1 – D. Garrett Dir. at 13.

[286] HOM TR. Vol. 2 at 558:2-6.

[287] CARD Exh. 1 – D. Garrett Dir. at 11-13.

[288] *Id* at DJG-3, Page 3 of 4.

[289] *Id.* at 14.

[290] *Id.*

"distance" between the curves is calculated using a technique known as the "sum of squared differences" (SSD). Specifically, the SSD for the Company's curve is 0.0157 while the SSD for the better-fitting CARD-recommended curve is 0.0112.[291] The smaller the value of the SSD, the better the mathematical fit is said to be.

CARD's S1.5-74 curve provides a better mathematical fit than does SWEPCO's L3-65 curve and results in a lower depreciation rate ,which given the economic hardship resulting from the COVID-19 pandemic, CARD suggests is added reason to adopt Mr. Garrett's recommendation. CARD's S1.5-74 curve decreases depreciation accrual by $130,874.[292]

Account 355 – Transmission Poles and Fixtures

For Account 355, CARD urges use of the L1.5-49 curve. In comparison, SWEPCO selected the S0.5-46 curve.[293] As with Accounts 353 and 354, both CARD's curve and SWEPCO's curve provide relatively close fits to the observed data.[294] However, CARD's curve has a superior mathematical fit to the data as its SSD is 0.0047 whereas SWEPCO's curve has an SSD of 0.0064.[295] Further, CARD's curve results in a lower depreciation rate, which given the economic hardship resulting from COVID-19, CARD suggests is added reason to adopt Mr. Garrett's recommendation. CARD's L1.5-49 curve decreases SWEPCO's depreciation accrual by $1,795,499.[296]

Account 356 – Overhead Conductors and Devices

For Account 356, CARD urges the ALJs to adopt the L1.5-80 curve. In comparison, SWEPCO selected the R2-70 curve.[297] As depicted in Figure 6 of Mr. Garrett's direct testimony, both CARD's curve and SWEPCO's curve provide relatively close fits to the truncated OLT curve.[298] Further, CARD's curve results in a lower depreciation rate, which given the economic

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[291] *Id.*

[292] *Id* at Exhibit DJG-3, Page 3 of 4.

[293] *Id.* at 15.

[294] *Id.* at 16.

[295] *Id* at 16, 5-6.

[296] *Id.* at Exhibit DJG-3, Page 3 of 4.

[297] *Id.* at 16.

[298] *Id.*

hardship resulting from COVID-19, CARD suggests is added reason to adopt Mr. Garrett's recommendation. CARD's L1.5-80 curve decreases SWEPCO's depreciation expense by $1,285,746.[299]

Account 364 – Distribution Poles, Towers and Fixtures

CARD recommends the L0-62 curve for this account.[300] SWEPCO had originally proposed the S0.5-55 curve, but in rebuttal testimony explained that it should have used the S-.5 curve instead of the S0.5-55 curve.[301] However, SWEPCO's switch from the S0.5-55 curve to the S-.5 does not change CARD's view as stated in Mr. Garrett's direct testimony that the L0-62 curve is the superior curve. As shown in SWEPCO's rebuttal testimony, both SWEPCO's revised choice of the S-.5 curve and CARD's L0-62 curve both provide close visual fits to the OLT data through the 80-year age interval.[302] SWEPCO's S-.5 curve results in an $847,189 decrease to depreciation expense and CARD's L0-62 curve decreases depreciation expense by $2,741,568.[303] Further, CARD's curve results in a lower depreciation rate, which given the economic hardship resulting from COVID-19, CARD suggests is added reason to adopt Mr. Garrett's recommendation.

Account 366 – Underground Conduit

CARD urges the ALJs to adopt the R4-80 curve for this account instead of SWEPCO's R4-70 curve.[304] As David Garrett explained, the full observed life table for this account shows a 70% survival rate at the 90-year age interval for the assets in this account.[305] Even though both curves assume that he retirement rate will decrease going forward, the Company's R4-70 curve is simply too short at this time given that the data show that 70% of the assets survive to the 90-year age interval. In addition, CARD's curve has an SSD of 0.0129 whereas SWEPCO's curve has an

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[299] *Id.* at Exhibit DJG-3, Page 3 of 4.

[300] *Id.* at 17, line 9.

[301] SWEPCO Exh. 43 – Rebuttal Testimony of Jason A. Cash at 29 (hereinafter, "SWEPCO Exh. 43 – Cash Rebuttal at __.").

[302] *Id* at 28, Figure "Account: SEP 101/6/ 364."

[303] *Id* at 29, lines 11-12; CARD Exh. 1 – D. Garrett Dir. at Exhibit DJG-3, Page 4 of 4.

[304] CARD Exh. 1 – D. Garrett Dir. at 19.

[305] *Id* at 19-20.

SSD of 0.0411, which shows that CARD's curve is the better mathematical fit.[306] CARD's recommended curve results in a $148,914 decrease to depreciation accrual.[307]

Account 367 – Underground Conductor

CARD urges the ALJs to adopt the R1-62 curve for this account, and SWEPCO recommends the R3-46 curve.[308] Figure 9 in David Garrett's direct testimony shows that SWEPCO's R3-46 curve does not provide a close visual fit or description of the historical retirement rate observed thus far in this account compared to CARD's proposed curve.[309] In addition, CARD's curve is a better mathematical fit – CARD's curve has an SSD of 0.0011 whereas the Company's curve has an SSD of 0.1426.[310] CARD's R3-46 curve will decrease depreciation accrual by $2,081,345.[311]

Account 369 – Distribution Services

For this account, CARD urges the ALJs to approve the R1.5-76 curve instead of SWEPCO's R3-59 curve.[312] CARD's proposed curve provides a better visual fit than does SWEPCO's curve.[313] In addition, CARD's curve has an SSD of 0.0254, compared to the SSD of 0.4459 for SWEPCO's curve, which shows that CARD's curve has a better mathematical fit.[314] CARD's proposed R1.5-76 curve will result in a decrease to SWEPCO's depreciation accrual of $806,053.[315]

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306 *Id* at 20.

307 *Id.* at Exhibit DJG-3, Page 4 of 4.

308 *Id* at 20.

309 *Id.* at 21.

310 *Id.*

311 *Id.* at Exhibit DJG-3, Page 4 of 4.

312 *Id.* at 22.

313 *Id* at 22, Figure 10.

314 *Id* at 23.

315 *Id.* at Exhibit DJG-3, Page 4 of 4.

Account 370 – Meters

CARD urges the ALJs to approve the O2-21 curve and SWEPCO proposes the L0-15 curve for this account.[316] As Mr. David Garrett explained, the primary purpose of Iowa curve fitting is to develop a smooth and complete survivor curve to conduct an average life calculation.[317] With regard to the data in this account, the OLT is already smooth and complete – as shown in Figure 11 of Mr. Garrett's direct testimony – which makes the Iowa curve fitting process relatively straight forward. For this account, CARD's O2-21 curve clearly provides a better visual fit than does SWEPCO's L0-15 curve. In addition, CARD's curve is a better mathematical fit, with an SSD of 0.0062 compared to the SSD of 0.7716 for SWEPCO's curve.[318] CARD's O2-21 curve decreases SWEPCO's depreciation accrual by $2,527,878.[319]

E. Purchased Capacity Expense

1. SWEPCO's Cajun Contract

SWEPCO proposes to recover a material amount of costs it incurred during the Test Year to purchase operating reserves from Cajun Electric Power Cooperative, Inc. ("Cajun Contract") through the Company's proposed base rates.[320] SWEPCO is proposing to treat such costs as capacity costs for the purposes of allocation those costs to Texas Retail customer classes. However, this proposed treatment is inconsistent with SWEPCO's treatment of purchased operating reserve costs in PUC Docket No. 50997, the Company's pending fuel reconciliation proceeding.[321]

In PUC Docket No. 50997, SWEPCO proposed to treat purchased operating reserves as reconcilable purchased energy costs, and recover such costs through the Company's fuel factor.[322]

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316 *Id* at 23.

317 *Id* at 24.

318 *Id*

319 *Id.* at Exhibit DJG-3, Page 4 of 4.

320 SWEPCO designates the cost of the operating reserves under the Cajun Contract as Highly Sensitive. The ALJs may find the amount of operating reserves SWEPCO seeks to recover in CARD Exhibit 3A – HIGHLY SENSITIVE Direct Testimony, Attachments, & Workpapers of Scott Norwood at 1-2.

321 CARD Exh. 3 – Norwood Dir. at 10-11; *see also* CARD Exh. 3 – Norwood Direct at Attachment SN-9.

322 *Id. at* 10; *see also* CARD Exh. 3 – Norwood Dir. at Attachment SN-9.

Specifically, SWEPCO witness Mr. Scott E. Mertz testified that "Regulation and operating reserve service purchases are energy-related amounts recorded in FERC Account 555 Purchased Power and are appropriately included in eligible fuel expense."[323] Contrarily, SWEPCO's proposal in this case to recover purchased operating reserves through base rates as *capacity* costs is entirely inconsistent with the Company's treatment of such costs in PUC Docket No. 50997. While CARD advocate for regulation and operating reserves services should be treated as purchased power capacity or demand related costs in Docket No. 50997, CARD now wants to ensure as a result of this case that SWEPCO classifies these costs consistently in both its fuel reconciliation *and* base rate proceedings.

Moreover, the Company's proposed recovery of purchased operating reserves costs through base rates is also inconsistent with the Commission's Final Order in PUC Docket No. 48973, in which the Commission concluded that costs of purchased operating reserves were reconcilable purchased *energy* costs and therefore recoverable through the fuel factor.[324]

Therefore, CARD urges the ALJs to remove the costs of operating reserves, purchased by SWEPCO under the Cajun Contract, from base rates, and instead allow SWEPCO to recover these costs through the Company's fuel factor as reconcilable purchased energy costs, beginning with the effective date of new rates approved in this case.

2. TIEC's Imputed Capacity Value for SWEPCO's Wind PPAs

Imputed capacity is the capacity value of a resource acquired under a purchase power agreement ("PPA") that does not have an explicit capacity or demand charge.[325] The concept of imputed capacity recognizes that some power purchases provide both capacity and energy to SWEPCO, even though the payments made to acquire these resources may be based entirely on a kilowatt-hour charge.[326]

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[323] CARD Exh. 3 – Norwood Dir. at Attachment SN-9.

[324] See PUC Docket No. 48973, Proposal for Decision at 14 and Order on Rehearing at Finding of Fact No. 98 (Feb 18, 2020).

[325] TIEC Exh. 4 – Direct Testimony of Billie S. LaConte at 22 (hereinafter, "TIEC Exh. 4 – LaConte Direct at__.").

[326] *Id*

Among SWEPCO's imputed capacity resources are its renewable energy resources that provide accredited capacity.[327] Accredited capacity means that for renewable energy resources, such as wind farms and solar plants that operate only when the wind is blowing or the sun is shining, and thus cannot generate their nameplate rating on a 24-7 basis. Unlike thermal generating resources, wind and solar facilities cannot generate their nameplate rating on a 24-7 basis; however, this does not mean that these renewable resources cannot provide capacity.[328]

In recognition of this fact, the Southwest Power Pool ("SPP") will accredit the operation of renewable resources and determine the amount of capacity that can be used to satisfy each load serving entity's resource obligation.[329] SPP's assignment of capacity is referred to as accredited capacity. Accredited capacity reflects the amount of capacity that SWEPCO can include in meeting SPP's minimum planning reserve margin.[330]

TIEC witness Ms. Billie LaConte recommends that SWEPCO's base rates be increased by approximately $2.3 million to include the estimated imputed capacity cost associated with four Wind PPAs, which have a cumulative nameplate rating of approximately 479 MW.[331] TIEC's proposed imputed capacity cost adjustment is based on applying an estimated imputed capacity value of $6.58 / kW-month or $78.96 / kW-year to the 79 MW accredited firm capacity rating of SWEPCO's Wind PPAs.[332] TIEC's proposed imputed capacity cost adjustment would result in a $2.3 million (Texas Retail) increase in SWEPCO's base rates for imputed capacity.[333]

To the extent the imputed costs are reasonably quantified, consistently and equitably allocated to customers, and reasonably reflective of costs and benefits of wind energy resources, CARD does not disagree with the concept of imputing capacity charges for wind energy PPAs and recovering such amounts through base rates. Similarly, CARD does not disagree with TIEC's use of the SPP's accredited capacity rating of SWEPCO's Wind PPAs (79 MW) as the basis for

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[327] *Id at* 23.

[328] *Id*

[329] *Id*

[330] *Id.*

[331] CARD Exh. 7 – Cross-Rebuttal Testimony and Attachments of Scott Norwood at 4 (hereinafter, "CARD Exh. 7 – Norwood Cross-Rebuttal at__.").

[332] *Id.*

[333] *Id*

calculating the imputed capacity value effective with the date imputed capacity costs are reflected in base rates.

However, the method adopted by TIEC to assign a value to the imputed capacity cost adjustment for SWEPCO's wind PPAs is based on an unreasonably high $78.96/kW-year estimate of the Company's avoided cost of capacity. Moreover, the method that TIEC used to arrive at the imputed capacity value has never been adopted by the Commission.[334]

As stated above, TIEC's witness Ms. LaConte imputed capacity value is based on the $80/kW-year avoided capacity cost proxy, which is used by utilities (*not the Commission*) to evaluate the cost-effectiveness of energy efficiency programs less the estimated cost of ancillary service costs.[335] Ms. LaConte arrived at this valuation by applying an estimated imputed capacity value of $6.58/kW-month ($78.96/kW-year) to the 79 MW accredited firm capacity rating of SWEPCO's Wind PPAs.[336] In reality, even SWEPCO itself currently forecasts that it will have excess capacity on its system until at least 2024, so the Company's current avoided cost of capacity is very low, with or without the Wind PPAs.[337] As shown in Table 1 from Mr. Norwood's Cross-Rebuttal testimony, below, SWEPCO's forecasted market price of capacity in the SPP is $9.13/kW-year over the course of the next ten years; an amount that is more than 8.5 times less expensive than the $6.58/kW-month or $78.96/kW-year avoided capacity cost estimate that Ms. LaConte used to calculate her imputed capacity adjustment.

Table 1

	SPP_Central ($/MW-day)	$/KW-yr
2021	$25.00	$9.13
2022	$25.00	$9.13
2023	$25.00	$9.13
2024	$25.00	$9.13
2025	$25.00	$9.13
2026	$25.00	$9.13
2027	$25.00	$9.13
2028	$25.00	$9.13
2029	$25.00	$9.13
2030	$25.00	$9.13

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[334] CARD Exh. 7 – Norwood Cross-Rebuttal at 4.

[335] TIEC Exh. 4 – LaConte Dir. at 25.

[336] *Id.* at 29-30.

[337] CARD Exh. 7 – Norwood Cross-Rebuttal at 4 and SN-CR-2.

TIEC's Ms. LaConte relies on an excerpt from testimony by El Paso Electric Company ("EPE") witness David Hawkins in PUC Docket No. 44941, which Ms. LaConte says "lays out the logic and methodology for identifying and quantifying the amount of imputed capacity costs."[338] However, the Commission did not adopt nor did it even mention EPE witness Hawkin's proposed method in the Final Order or Unanimous Stipulation in PUC Docket No. 44941.[339]

Therefore, CARD urges the ALJs to disallow TIEC witness Ms. LaConte's proposed imputed capacity adjustment. As stated above, while CARD agrees with the concept of imputing capacity value to wind energy contracts, TIEC's proposed imputed capacity cost adjustment for SWEPCO's Wind PPAs is based on an unreasonably high $78.96/kW-year estimate of the Company's avoided cost of capacity. SWEPCO currently has excess capacity on its system and forecasts that the cost of capacity available for purchase within SPP will be below $10/kW-year over the course of the next decade.

F. Affiliate Expenses [PO Issue 42]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

G. Federal Income Tax Expense [PO Issues 32, 33]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

H. Taxes Other Than Income Tax [PO Issue 30]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

1. Ad Valorem (Property) Taxes

2. Payroll Taxes

3. Gross Margin Tax

I. Post-Test-Year Adjustments for Expenses [PO Issue 45]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

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[338] CARD Exh. 7 – Norwood Cross-Rebuttal at 4.

[339] *Id.*

V. Billing Determinants [PO Issue 4, 5, 6, 54]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

VI. Functionalization and Cost Allocation [PO Issues 4, 5, 52, 53, 55, 56, 57, 58]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

A. Jurisdictional Allocation [PO Issues 55, 57]

B. Class Allocation [PO Issues 53, 58]

1. SWEPCO's Adjustments to the Proposed Allocation Factors Approved in Docket No. 46449

CARD urges the ALJs to reject the following adjustments SWEPCO made to the allocation factors and underlying allocation methodologies approved in PUC Docket No. 46449. Contrary to SWEPCO's assertion that the "the allocation factors and process are the same as those approved by the Commission in Docket No. 46449 and updated in Docket No 48233," the record evidence shows that this is not the case.[340]

a. SWEPCO's Allocation of Line Transformers

In SWEPCO witness John Aaron's rebuttal testimony,[341] Mr. Aaron recommended an adjustment to SWEPCO's class cost-of-service study to adjust the allocation of line transformer costs. Specifically, in its filed direct case, SWEPCO allocated both primary and secondary line transformer costs (FERC Account 368) among the customer classes on the same percentage basis. However, Nucor Steel witness Mr. Jim Daniel argued that allocations should be different for primary and secondary line transformer costs. In a deviation from the allocation factors and methodologies the Commission approved in Docket No. 46449 and from SWEPCO's response to CARD RFI 11-7, SWEPCO incorporated this adjustment to the allocation of line transformer costs in the Company's rebuttal cost of service study.[342]

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[340] CARD Exh. 19.

[341] SWEPCO Exh. 54 – Rebuttal Testimony of John Aaron at 2 (hereinafter, SWEPCO Exh. 54 – Aaron Rebuttal at__.").

[342] SWEPCO Exh. 54 – Aaron Rebuttal at 2.

This adjustment to the allocation of line transformer costs in the Company's rebuttal cost of service study will result in an improper allocation of costs. While the allocations SWEPCO presented in its as-filed cost of service study did not change the primary line transformer cost allocations, the allocation presented in SWEPCO's rebuttal cost of service study did unfairly result in the secondary class receiving a higher allocation of secondary line transformer costs, and subsequently more total line transformer costs.[343]

b. SWEPCO's Improper Adjustment to Assignment of Costs to Wholesale Class

SWEPCO again deviated from the methodology approved in PUC Docket No. 46449 when the Company adjusted how costs are assigned to the wholesale class. In Mr. Aaron's rebuttal testimony, Mr. Aaron discusses SWEPCO's response to East Texas Electric Cooperative and Northeast Texas Electric Cooperative RFI 2-5 ("ETEC-NTEC 2-5"), in which SWEPCO responded that "there should be no direct assigned costs to the wholesale class in the jurisdictional cost of service study" because SWEPCO collects revenues from the wholesale customers for the associated investment, which reduces the cost allocation.[344]

Mr. Aaron's rationale is incorrect. By adjusting the assignment of costs so that there are no directly assigned costs to the wholesale class, SWEPCO is improperly removing the allocation of certain distribution costs from the wholesale jurisdiction, which consequently increases the allocation to other jurisdictions. Mr. Aaron alleged that the increased cost allocation is offset by a larger allocation of distribution miscellaneous revenues but provided no support for this. Absent an understanding of how this change impacts the rate classes and recognizing that this change deviates from the methodology approved in Docket No. 46499, CARD urges the ALJs to reject SWEPCO's proposed adjustment and instead recommend that the treatment of wholesale costs and revenues reflect the methodology contained in SWEPCO's as-filed Cost of Service Study.

c. SWEPCO's Improper Adjustment to the Allocation of Major Account Representative Costs

In Mr. Aaron's rebuttal testimony, SWEPCO made two changes to the cost of service study presented in SWEPCO's direct case. The first change SWEPCO made was to the components of

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[343] SWEPCO Exh. 54A – Workpapers to the Rebuttal Testimony of John Aaron.

[344] SWEPCO Exh. 54 – Aaron Rebuttal at 6.

its Test-Year prepayment balances included in rate base.[345] The second adjustment SWEPCO made was to the quantification and allocation of major account representative costs recorded in FERC Account 908.[346] These changes do not appear to be consistent with the allocation factors approved in Docket No. 46449.[347] Although they have a relatively small impact on the overall revenue requirement, CARD urges the ALJs to reject the adjustment to the components of the Test-Year prepayment balances included in rate base and the adjustment SWEPCO made to the quantification and allocation of major account representative costs recorded in FERC Account 908.

TABLE 1

	FILED	REBUTTAL	CHANGE
Texas Retail	$ 451,529,538	$ 446,466,201	$ (5,063,337)
Residential	$ 188,152,651	$ 188,778,452	$ 625,801
Commercial	$ 193,497,125	$ 191,044,316	$ (2,452,809)
Industrial	$ 57,506,958	$ 54,451,107	$ (3,055,851)
Municipal	$ 4,303,143	$ 4,219,413	$ (83,730)
Lighting	$ 8,069,661	$ 7,972,913	$ (96,748)

The result of SWEPCO's adjustments and deviation from the allocation factors the Commission approved in Docket No. 46449 was to shift costs from SWEPCO's as-filed cost of service study to its rebuttal cost of service study as reflected in Mr. Aaron's Table 1, above. As the table shows, the adjustments addressed above lead to an overall decline in costs allocated to the Texas jurisdiction by $5.1 million from the Company's as-filed case to its rebuttal case. However, even though Texas, as a whole, saw a $5.1 million reduction, the Texas Residential class saw an overall increase of nearly $626,000 while all other classes saw reductions in allocated costs.

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[345] *Id* at 7.

[346] *Id*

[347] Docket No. 46449, Order on Rehearing at 47.

The adjustments proposed in SWEPCO's rebuttal case only serve to shift costs to the Residential class. While certain of SWEPCO's adjustments are supported by the Final Order in Docket No. 46449, the adjustments discussed above are proposed by commercial and industrial parties that shift costs to the Residential class based on allocation factors that deviate from the factors approved in Docket No. 46449. It is unreasonable to adopt these unreasonable changes in allocation factors and CARD urges the ALJs to reject them.

2. ETSWD's Recommendation to Update Texas Retail Rate Class Allocation Study

CARD urges the ALJs to reject East Texas Salt Water Disposal's witness Ms. Kit Pevoto's recommendation to update SWEPCO's Texas Retail rate class cost allocation study to account for temporary changes to electricity usage during the COVID-19 pandemic. Specifically, Ms. Pevoto proposes that SWEPCO's Texas Retail rate class cost allocation study should be updated to account for changes to electricity usage caused by the COVID-19 pandemic or at least revised to include all known and measurable adjustments related to COVID-19 pandemic impacts.

a. The Closure of Three Industrial Plants Are Only Known and Measurable Changes

SWEPCO itself explained that, other than the removal of three specific industrial customers, the Company has made no generic pro-forma adjustments for COVID-19 impacts to the Test Year load and customer data because the impacts of COVID-19 were neither fully known nor measurable.[348]

Specifically, the three closures consisted of U.S. Steel at Lone Star, Texas and at Hughes Springs, Texas; Domtar at Ashdown, Arkansas; and Libbey Glass at Shreveport, Louisiana by the end of 2020.[349] These three aforementioned industrial customers announced the permanent closure of their respective operations after the end of the Test Year. In total, U.S. Steel, Domtar, and

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[348] CARD Exh. 8 – Cross-Rebuttal Testimony of Karl Nalepa at 2 (hereinafter, "CARD Exh. 8 – Nalepa Cross-Rebuttal at __.").

[349] East Texas Salt Water Disposal Exh. 1 – Direct Testimony of Kit Pevoto at 8 (hereinafter, "ETSWD Exh. 1 – Pevoto Dir. at __.").

Libbey Glass used approximately 403.4 GWh of electricity during the Test Year.[350] CARD agrees with SWEPCO's pro forma adjustments to account for the closures of the three industrial plants.

b. There are No Known and Measurable Changes for the Impact of the COVID-19 Pandemic

Beyond the pro forma adjustments for the three industrial plant closures resulting in a known and measurable change after the Test Year, no other incident or happening or occurrence has taken place since the end of the Test Year that would justify SWEPCO to make a pro-forma adjustment to the Test Year billing determinants, including the impact of the COVID-19 pandemic.

Ms. Pevoto testified that SWEPCO noticed an overall decline in its retail sales since the start of the COVID-19 pandemic in March 2020 and, compared to 2019, SWEPCO's total Texas Retail kWh sales dropped 3.2% in 2020.[351] Furthermore, while residential kWh sales increased by 3.3%, Commercial and Industrial kWh consumption declined by 5% and 6.9%, respectively.[352]

Ms. Pevoto also asserted that if no pro-forma adjustments to reflect COVID-19 pandemic impacts are made to the Test Year load and customer information, the costs assigned to rate classes experiencing energy usage reductions (*i.e.*, Commercial and Industrial) could be overstated while costs assigned to rate classes experiencing increased energy usage would be understated (*i.e.*, Residential).[353]

However, Ms. Pevoto fails to include in her analysis that the Texas economy and the norms and behaviors of its citizens are all close to returning to pre-pandemic levels. The Test Year ended March 31, 2020, and Ms. Pevoto, through her Cross-Rebuttal Testimony, suggests that SWEPCO should instead use Calendar Year 2020 to determine Test Year revenues.[354] By using 2020 load data, ETSWD aims to capture the impact of COVID-19, which would alter the billing determinants in a manner that assigns costs more favorably to the Oil Field Class. However, as discussed above, the impact of the COVID-19 pandemic is not a known and measurable change. COVID-19 began in March of 2020, and while the virus is still present, nearly half of the United States is fully

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[350] East Texas Salt Water Disposal Exhibit 2 – Cross-Rebuttal Testimony of Kit Pevoto at 8 (hereinafter, "ETSWD Exh. 1 – Pevoto Cross-Rebuttal at __.").

[351] ETSWD Exh. 1 – Pevoto Dir. at 10.

[352] CARD Exh. 8 – Nalepa Cross-Rebuttal.

[353] ETSWD Exh. 1 – Pevoto Dir. at 13.

[354] ETSWD Exh. 2 – Pevoto Cross-Rebuttal at 6.

vaccinated, more than one-third of Texans are fully vaccinated, and nearly half of Texas citizens have received at least one dose of the vaccine.[355]

If the ALJs were to adopt ETSWD's proposal to use the 2020 Calendar Year rather than the Test Year, the billing determinants would be based on a transitory effect rather than a known and measurable change. More importantly, the rates would likely be in effect for three to five years before SWEPCO files its next base rate case causing rate payers in the Residential rate class to pay a rate that is disproportionate to the cost it actually caused the utility to incur.

Crucially, neither Ms. Pevoto nor any other witness on behalf of ETSWD has proposed a specific COVID-19 pro forma adjustment. Ms. Pevoto simply proposed that SWEPCO's cost allocation study should be revised to include all known and measurable adjustments related to COVID-19 pandemic impacts, not just for the three large industrial customers discussed above.[356]

Clearly COVID-19 restrictions have forced many workers into home offices and many businesses to temporarily or permanently close in 2020. But no one knows how many workers will return to their pre-COVID-19 work locations and certainly not when. Even though the very Hearing on the Merits that this Initial Brief addresses was held via Zoom videoconference, the vast majority of the parties attended the Zoom hearing at their respective offices rather than their homes. Likewise, no one knows, other than for the three specific industrial customers that have demonstrated permanent closures due to COVID-19, when and which businesses that closed will reopen and resume pre-COVID-19 operations. The only known and measurable change that can be made is the one that SWEPCO has already made - to remove the impact of the three specific industrial customers.

Therefore, CARD urges the ALJs to reject ETSWD's proposal to use the 2020 Calendar Year rather than the Test Year ending March 31, 2020. While there is no question that there have been changes in consumption patterns among the different rate classes during the COVID-19 pandemic that does not change the fact that there is no known and measurable adjustment to make.

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[355] Covid.cdc.gov/covid-data-tracker/#vaccinations.

[356] ETSWD Exh. 1 – Pevoto Dir. at 14.

C. Municipal Franchise Fees [PO Issue 31, 56]

VII. Revenue Distribution and Rate Design [PO Issues 4, 5, 47, 48, 52, 59, 60, 61, 62, 75, 76, 77, 78, 79]

A. Rate Moderation / Gradualism [PO Issue 52]

1. Nucor Steel's Recommended Rate Moderation Plan

CARD urges the ALJs to reject Nucor Steel witness Mr. James Daniel's proposal to spread the revenue shortfall from any rate moderation plan to all rate classes that receive below average base rate revenue percent increases. CARD recommends instead that the revenue shortfall be assigned within the respective major class groupings as proposed by SWEPCO.

Nucor Steel recommends that the ALJs reject SWEPCO's proposed revenue distribution and instead advocates that gradualism should only be applied for three small rate classes.[357] Nucor Steel proposes that the base rate revenue increases for these three rate classes be limited to 1.5 times the system average rate increase. Nucor Steel then proposes that the revenue shortfall resulting from this gradualism adjustment be proportionately assigned to those rate classes that receive below average base rate revenue percentage increases.[358]

CARD agrees that a gradualism adjustment is an important revenue distribution tool that should be applied when necessary to protect customers from significant rate increases. However, CARD does not agree with Nucor Steel's proposal to spread the revenue shortfall to those rate classes that receive below average base rate revenue percent increases because it is not necessary to do so. The result of Nucor Steel's proposal is that, based on SWEPCO's as-filed revenue distribution, 85% of the revenue shortfall[359] is assigned to the residential class, which is already at its allocated cost of service.

Instead, it is reasonable to assign the revenue shortfall attributable to the Cotton Gin Service within the commercial customer group, the revenue shortfall attributable to the Oilfield Secondary Service within the industrial customer group and the revenue shortfall attributable to

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[357] Cotton Gin Service, Oilfield Secondary Service, and Public Street and Highway Lighting Service. *See* Nucor Steel Exh. 1 – Direct Testimony and Exhibits of James W. Daniel at 16 (hereinafter, "Nucor Exh. 1 – Daniel Dir. at __.").

[358] Nucor Exh. 1 – Daniel Dir. at 16.

[359] $359,599 / $412,839 = 85.2%. *See* Nucor Exh. 1 – Daniel Dir. at Exhibit JWD-6.

the Public Street and Highway Lighting Service within the municipal service and street lighting group. There is no need to spread the revenues beyond these groups. Thus, CARD urges the ALJs to reject Nucor Steel's proposal to spread the revenue shortfall from any rate moderation plan to all rate classes that receive below average base rate revenue percent increases and adopt SWEPCO's methodology to spread the revenue shortfall only within the major class groups.

2. Staff's Recommended Four-Year Phased-In Rate Moderation Plan

CARD urges the ALJs to reject Commission Staff witness Mr. Adrian Narvaez's proposed four-year phased-in approach to rate moderation.[360] Mr. Narvaez recommends that the Commission should reject SWEPCO's proposed revenue distribution proposal and instead approve a four-year phased-in revenue distribution approach to achieve gradual movement towards cost-based rates for each class in SWEPCO's class cost of service study.[361]

Four-Year Phased in Approach

Mr. Narvaez's four-year phased-in approach would operate as described below:

1. The initial rates start with the approved class cost of service study ("CCOSS"), except that the revenue increase for any individual class, net of changes in TCRF and DCRF revenues, would be capped at 43%.[362] The residual revenues from classes subject to the 43% cap would be reallocated proportionally among the classes within the rate bundle that are not subject to the 43% cap. At Staff's proposed CCOSS level, the Cotton Gin, Oilfield Secondary Service, and the Public Street and Highway Lighting classes experience a net cost-based increase greater than 43%.[363]

2. The second-year rates would be set to cap revenue increases for any individual class, net of changes in TCRF and DCRF revenues, at an additional 43% from present test-year base-rate related revenues. At Staff's proposed CCOSS, cost-

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[360] Staff Exh. 4 – Direct Testimony of Adrian Narvaez at 6 (hereinafter, "Staff Exh. 4 – Narvaez Dir. at __.").

[361] *Id* at 6.

[362] *Id.* at 19.

[363] *Id* at 23-24.

based net revenue increases for all classes are below the 86% cap,[364] except Public Street and Highway Lighting class, which would still be above the 86% cap. Thus, the Public Street and Highway Lighting class would be capped at an 86% net increase and the remaining residual revenue amount would be allocated proportionally among the other classes within the Municipal rate bundle.[365]

3. The third-year rates would be set to cap revenue increases for any individual class, net of changes in TCRF and DCRF revenues, at an additional 43% from present test-year base-rate related revenues. At Staff's proposed CCOSS, the Public Street and Highway Lighting class, which would still be above the 129% cap.[366] Thus the Public Street and Highway Lighting class would be capped at a 129% net increase and the remaining residual revenue amount would be allocated proportionally among the other classes within the Municipal rate bundle.[367]

4. The fourth-year rates would be set to cap revenue increases for any individual class, net of changes in TCRF and DCRF revenues, at an additional 43% from present test-year base-rate related revenues. At Staff's proposed CCOSS, the Public Street and Highway Lighting's cost-based net revenue increase is 170.45%, which is below the 172% cap.[368] This means that all rates would finally be set at cost after four years.

Staff's Phased-In Approach Assumes Zero Change in Costs and Revenues Amongst Classes

Mr. Narvaez's proposal has one crucial flaw – the proposal is based on the idealistic simplification that present Test Year base-rate revenues remain constant over the four-year term of the phase-in plan. Mr. Narvaez admitted that consumption patterns amongst each rate class are subject to change, proving that Staff's own recommended rate moderation plan operates under an assumption that does not and cannot exist in reality.[369] Moreover, Mr. Narvaez's plan ignores the

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[364] 43% cap in phase I plus 43% in phase II = 86% cumulative cap.

[365] Staff Exh. 4 – Narvaez Dir. at 24.

[366] 43% cap in phase I plus 43% in phase II plus 43% in phase III = 129% cumulative cap.

[367] Staff Exh. 4 – Narvaez Dir. at 25.

[368] 43% cap in phase I plus 43% in phase II plus 43% in phase III plus 43% in phase IV = 172% cumulative cap.

[369] HOM TR. Vol. 4 at 1414:18-21.

reality that rate classes grow at different rates in between the Company's base rate cases. During the Hearing on the Merits, Mr. Narvaez himself admitted that costs and revenues associated with each class are subject to change between the Test Year in this case and the Test Year in SWEPCO's next base rate case.[370] Consequently, when the phase-in plan is based on an unrealistic assumption that the relative class revenues remain constant, the result is one where the classes move further away from costs rather than closer to costs.[371]

Table 1 from Mr. Nalepa's Cross-Rebuttal testimony, below, summarizes the change in present revenues (including TCRF and DCRF revenues) by major customer classes since SWEPCO's last rate case in Docket No. 46449.[372] As Mr. Nalepa's Table 1, below, demonstrates, the growth in class revenues ranges from, 0.6% to 35.2% over the course of the four years between test years.[373]

Table 1 – Change in Class Revenues Between Docket No. 46449 Test Year and Docket No. 51415 Test Year

Customer Class	Pct. Change
Residential	13.9%
General Service	21.8%
Lighting & Power	11.4%
Cotton Gin	12.1%
Large Lighting & Power	3.2%
Metal Melting	32.5%
Oilfield	35.2%
Municipal & Municipal Lighting	20.3%
Outdoor Lighting	0.6%

In addition to the class revenues changing, the class costs will also change, thus rendering the fixed base-rate revenues stale before the four-year rate phase-in is complete. Rates are fixed

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370 *Id* at 1414:13-17.

371 CARD Exh. 8 – Nalepa Cross-Rebuttal at 7-8.

372 *Id* at 8.

373 PUC Docket No. 46449 Test Year end is June 30, 2016; the Test Year in PUC Docket No. 51415 ends March 31, 2020.

based on a test year "snapshot" of revenues and expenses. Rather than using four consecutive years of annual rate changes, a better approach is to establish an acceptable rate moderation plan in this case and modify it as necessary when SWEPCO files its next base rate case.

CARD does not contest the fact that rate shock can be and is a real concern. Similarly, CARD acknowledges that the Commission has approved rater moderation plans in cases where large rate increases would otherwise be imposed on customers. However, the Commission has never approved a rate moderation plan for an electric utility that comprised a four-year phase-in of rates.[374] Therefore, CARD urges the ALJs to reject Staff's proposed four-year phased-in rate moderation plan.

B. Rate Design and Tariff Changes [PO Issues 60, 61, 62]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

C. Transmission Rate for retail behind-the-meter generation

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

D. Riders [PO Issues 47, 48, 75, 76, 77, 78, 79]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

1. Proposed Residential Service Plug-in Electric Vehicle Rider [PO Issues 75, 76, 77, 78, 79]

2. Renewable Energy Credit Rider [PO Issues 47, 48]

E. Retail Choice Pilot Project

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

VIII. Baselines for Cost-Recovery Factors [PO Issue 4, 5, 52, 63]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

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[374] Staff Exh. 4 – Narvaez Dir. at 25.

A. Interim Transmission Cost of Service

B. Transmission Cost Recovery Factor

C. Distribution Cost Recovery Factor

D. Generation Cost Recovery Rider

IX. Reasonableness & Recovery of Rate Case Expenses [PO Issues 26, 27, 28]

PURA Section 33.023 requires that SWEPCO reimburse CARD for the reasonable costs of its participation in a ratemaking proceeding to the extent that the Commission determines the expenses to be reasonable.[375] CARD thus requests reimbursement for its reasonable costs of participation in this proceeding and in the following additional rate-making proceedings:

- *PUC Docket No. 50997, Application of Southwestern Electric Power Company for Authority to Reconcile Fuel Costs;*
- *PUC Docket No. 49042, Application of Southwestern Electric Power Company to Amend Its Transmission Cost Recovery Factor;*
- *PUC Docket No. 47141, Review of Rate Case Expenses Incurred by Southwestern Electric Power Company and Municipalities in Docket No. 46449;*
- *PUC Docket No. 46449, Application of Southwestern Electric Power Company for Authority to Change Rates;*
- *PUC Docket No. 40443, Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs;*

Ms. Catherine Webking provided direct testimony supporting the reasonableness of CARD's rate case expenses incurred in Docket Nos. 51415, 50997, 49042, 47141, 46449 and 40443 for which it requests reimbursement in this case.[376]

Ms. Webking reviewed Herrera Law & Associates, PLLC's ("HL&A") fees and expenses for Docket Nos. 51415, 50997, 49042, 47141, 46449 and 40443, including the Affidavit of Alfred R. Herrera, lead attorney for CARD in the aforementioned proceedings, which CARD provided in

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[375] PURA § 33.023.

[376] CARD Exh. 5 – Direct Testimony and Attachments of Catherine Webking (hereinafter, "CARD Exh. 5 – Webking Dir. at __.").

further support of its request.[377] Ms. Webking concluded that under the standards established by the Commission's rate case expense rule – 16 Tex. Admin. § 25.245 – that CARD's rate case expenses are reasonable and recoverable under PURA 33.023.[378] Ms. Webking testified that she has personal knowledge of the legal skills and experience of Mr. Herrera and his associates and has participated in numerous contested cases where she and Mr. Herrera both represented parties involved in complex contested cases before SOAH and the PUC. Ms. Webking concluded that based on Mr. Herrera's extensive experience and the experience of the other attorneys who billed time to the cases for which CARD seeks reimbursement, HL&A's hourly rates are reasonable and compare favorably to the rates of other attorneys representing municipalities in similar contested rate cases.[379]

With regard to CARD's rate expenses incurred in Docket No. 51415, Ms. Webking opined that CARD's level of participation is justified by the size and complexity of the case.[380] Specifically, Ms. Webking considered factors such as: the large base revenue increase of 26% that SWEPCO seeks in this proceeding, the fact that CARD is the only active group of municipalities in this proceeding, CARD's development and filing of twelve sets of discovery at the time Ms. Webking's testimony was filed, and CARD's filing of the testimonies of six witnesses as reasons for her conclusion that the extent of CARD's involvement and time billed to this proceeding was justified and reasonable. Further, Ms. Webking determined that CARD had appropriately allocated its time for each substantive issue and phase of the case as required by 16 Tex. Admin. Code § 25.245(b)(6).

Ms. Webking also concluded that CARD's level of participation in the five cases other than Docket No. 51415 for which CARD requests reimbursement is also commensurate with the scope and complexity of the issues and the amount of SWEPCO's costs that were under consideration in those rate proceedings.[381]

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[377] *Id* at 4-5.

[378] *Id* at 5.

[379] *Id.*

[380] *Id.*

[381] *Id* at 6.

Ms. Webking found that the fees and expense of CARD's consultants are reasonable.[382] Specifically, Ms. Webking noted that each consultant contributed to development of and analysis of discovery requests and responses that each expert contributed in the substantive technical review of the SWEPCO's application and the development of direct testimony. Further, Ms. Webking determined that each expert-witness firm's recorded billings are based on reasonable hourly rates and that their expenses were supported with reasonable detail and were not excessive or duplicative.

Thus, CARD requests at this time that it be reimbursed $648,985.96 for its rate case expenses incurred in relation to Docket Nos. 51415, 50997, 49042, 47141, 46449 and 40443 through March 31, 2021.[383] CARD has incurred additional rate case expenses subsequent to March 31, 2021 and will continue to incur additional rate case expenses. As discussed during the hearing on the merits in this proceeding, CARD will file additional rate case expense documentation in mid-June 2021 and additional updated documentation by July 6, 2021.[384] Thus CARD's request for reimbursement of its rate case expenses will be updated and reflected in its anticipated July 6, 2021 filing.

X. Other Issues [including but not limited to PO Issues]

Not briefed. CARD reserves the right to respond to other parties' briefs on this issue.

A. Additional issues

B. CWIP [PO Issue 17]

C. Cash Working Capital [PO Issue 18]

D. Administrative and General O&M Expenses [PO Issue 25]

E. Tax savings from liberalized depreciation [PO Issue 34]

F. Advertising expense [PO Issue 35]

G. Competitive affiliates [PO Issue 43]

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[382] *Id*

[383] *Id* at 7.

[384] HOM TR. Vol. 6 at 1558:9-18.

H. Deferred Costs [PO Issue 50, 51]

I. Proposed Time-of-Use Rate Pilot Projects [PO Issues 80, 81, 82, 83, 84, 85]

J. Experimental Economic Development Rider

K. Any exceptions requested to PUC rules [PO Issue 64]

L. Should PUC approve requests for waivers? [PO Issue 65]

M. Compliance with Dkt. 46449 [PO Issue 66]

XI. Conclusion

Respectfully submitted,

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ATTORNEYS FOR CITIES ADVOCATING REASONABLE DEREGULATION

CERTIFICATE OF SERVICE

I hereby certify that on this the 17th day of June, 2021 a true and correct copy of the ***Cities Advocating Reasonable Deregulation's Initial Post-Hearing Brief*** was served upon all parties via electronic mail in compliance with SOAH Orders Nos. 4 and 13, and with the Commission's Order Suspending Rules, issued in Project No. 50664.

By: */s/ Leslie Lindsey*

Leslie Lindsey